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BONNEVILLE POWER ADMINISTRATION'S REPAYMENT OF ITS OBLIGATIONS TO THE U.S. TREASURY

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON THE

HISTORY AND METHODOLOGY OF THE BONNEVILLE POWER ADMINISTRATION'S REPAYMENT OF ITS OBLIGATIONS TO THE U.S. TREASURY

SEPTEMBER 13, 1984

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BONNEVILLE POWER ADMINISTRATION'S REPAYMENT OF ITS OBLIGATIONS TO THE U.S. TREASURY

THURSDAY, SEPTEMBER 13, 1984

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m., in room SD-366, Dirksen Office Building, Hon. Daniel J. Evans presiding.

Present: Senators Evans, McClure, Hecht, Ford, and Metzenbaum.

Also present: Gary Ellsworth, deputy chief counsel for natural resources; D. Michael Harvey, chief counsel for the minority; and Craig Gannett, counsel for the minority.

OPENING STATEMENT OF HON. DANIEL J. EVANS, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator EVANS. This hearing will come to order. It is the Energy and Natural Resources oversight hearing on the history and methodology of the Bonneville Power Administration's repayment of its obligations to the U.S. Treasury.

I have just a short opening statement. We have a distinguished group of witnesses and the first of those will be our colleague from the House of Representatives, Representative Weaver.

The Committee on Energy and Natural Resources is pleased to be able to conduct the oversight hearings today on the repayment methodology of the Bonneville Power Administration. Chairman McClure has asked me to chair these hearings, although he hopes to attend to the extent that his schedule permits.

BPA repayment is a subject that has come up several times on the floor of the Senate during the past year and, in my view, deserves a thorough hearing before this committee. I am particularly pleased to conduct these hearings with Senator Metzenbaum, who has emerged as the Member of the Senate who has raised serious and legitimate questions on this subject.

While one oversight hearing probably will not be adequate, I hope we can make a good start today toward identifying the key issues in this complex subject.

One of the great natural resources of the Pacific Northwest is the Columbia River system and its tributaries. Since the construction of the main Grand Coulee powerhouse and other dams on the Columbia in the 1930's, an immensely productive system of multipurpose dams and electric transmission systems has been developed largely with the assistance of the Federal Government.

This has been the backbone of economic development of the region for the past half century. Many citizens, both in and outside of the region, have benefited from the construction of these facilities. Among these benefits are efficient aluminum plants, which date back to the World War II armaments effort, and, certainly not least of all, a rich and significantly growing and internationally important agricultural sector.

The Bonneville Power Administration was established by the Bonneville Project Act of 1937, primarily for the purpose of marketing power from the Federal dams on the Columbia within the Pacific Northwest. It has since grown into one of the largest wholesale sellers of electricity in the Nation, although it is a Federal agency and does not own its own generation facilities.

Over the years, Bonneville has carried out an increasingly complex mission of responsibilities. Most recently, it has been required by the Northwest Power Act of 1980 to place special priority on conservation in its future resource acquisitions, and to carry out an extensive program to restore fish runs on the Columbia River and its tributaries.

As chairman of the Northwest Power Planning Council for the last 2½ years, I experienced personally the broad and evolving challenges facing Bonneville. In that sense, its responsibilities are fundamentally different from the objectives of a private electrical utility.

Prompt repayment of the Federal investment is a responsibility of BPA that some feel should receive the highest priority today. I share these sentiments. One of the debates on the Senate floor, which I participated in soon after being sworn into the Senate in September 1983, was on this very subject with Senators Metzenbaum, McClure, and Hatfield.

I do want to mention two important points for the record which I believe deserve important consideration.

First, maximum revenue and maximum rate are not necessarily the same. In order for Bonneville to meet its Federal repayment requirements, revenues from its various customer groups must be sufficient to meet its various obligations, including interest and principal on the Federal investment.

The energy-intensive industries of the Northwest, however, such as aluminum, deep-well-irrigated agriculture, and pulp and paper are extremely sensitive to rapid, large increases in the cost of electric energy. Certain industries may well decide to leave the region if higher electricity prices make their products uncompetitive. In fact, some of that is currently happening.

The sudden departure of such industries would leave Bonneville with a much lower revenue base, as well as saddled with a sudden surplus of nonfirm energy which recently has been dumped literally at bargain-basement prices outside the Northwest. There are alternative methods to increase the flow of revenue to BPA which may involve reducing BPA's rates in certain selected cases. The recent lower incentive rate for the aluminum companies and the proposed pilot program for irrigators to utilize nonfirm energy are such examples.

Second, the hydroelectric energy system in the Pacific Northwest is subject to large variations in its fuel source, its streamflows.

Slight variations in snowpack and rainfall can cause enormous impacts on an approximately 20,000-megawatt system. Furthermore, storage capacity in existing reservoirs is limited compared with annual streamflows.

In this respect, the Bonneville system differs from the thermal-based systems which have predictable sources of fuel supply. For these reasons, any alternative repayment methodology should have the flexibility to deal with low-rainfall years and economic fluctuations.

There are many other questions that need to be addressed, which I hope that we will be able to examine some of these today in detail. I believe the interests of the U.S. Treasury and the Northwest ratepayers can be reconciled in an equitable manner. Whether the best route is fine tuning the existing methodology through good management and forecasting or through an alternative repayment system is difficult to judge yet.

Once we have a better base of information and data, we can deal with this question more intelligently. That is precisely the aim of the oversight hearing today, and the committee looks forward to working with Bonneville and the other institutions represented here more closely in the future.

Senator Metzenbaum, do you have an opening statement?

STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. Mr. Chairman, I requested this hearing because I am increasingly concerned about the ability of the Bonneville Power Administration to repay the $7.9 billion it owes to the Federal Government. I have some strong feelings about certain issues. One of the issues that concerns me very much is that when you owe the Federal Government money, you ought to pay it. And that is the issue that we have before us in this legislation.

Incidentally, just yesterday we had a rather similar issue on a different act having to do with people's bid for timber, also in the Northwest, wanting to be relieved of their contracts. I have an old-fashioned feeling on that subject. If you owe somebody some money you ought to pay it. I commend Senator McClure for holding this hearing and appreciate Senator Evans' chairing it. I hope it is a first step toward putting the Bonneville debt on a regular payment schedule.

Bonneville owes $7.9 billion to the Federal Government for the Federal investment in generation and transmission facilities that are part of the Columbia River basin system.

No one disputes the fact that the money is owed. The question is how and when Bonneville will repay that debt.

So far, Bonneville has repaid only $638 million of that $7.9 billion. In the past 10 years, it has repaid only $43 million. Over the past 6 years, Bonneville has not been able to repay any of the principal owed and, in fact, has not even made full interest payments on that debt during that 6-year period. As a matter of fact, I noted that in Energy Daily recently that the Administrator of Bonneville Power Administration last Friday, and I don't have the date of this article, but I guess it is rather recent, just very recent, it says: "We

have turned the corner. Sharp increases in BP rates that began in 1974 have come to an end," exulted Peter Johnson, the agency's Administrator. "We can't completely eliminate rate increases, but we can keep them within reasonable limits."

I am not for rate increases. I am for meeting your obligation. I am for the old-fashioned way of doing business, pay the bills that you owe. That has not happened. So when Mr. Johnson exults over the fact that the rate increase is being held at 10 percent, it is at the cost of the rest of the American taxpayers, because the bills are not being paid and under normal circumstances if you are doing business with a private creditor, you would have a foreclosure.

Technically, Bonneville has not violated the law, because no set schedule for repaying the debt is mandated. Whenever it misses a payment, Bonneville simply rolls that amount over to the next year. That is a bad way of doing business. But that system obviously cannot go on forever. Although there are some who are now permitting the Federal budget to be increased on, and on, and on, and somehow think that it can go on forever. It can't go on forever with respect to the Federal budget and it can't go on forever with respect to the debt that Bonneville owes the Federal Treasury.

FERC has warned that consumers in the Northwest areas served by Bonneville will face a "bow wave" of deferred payments after the turn of the century. Obviously, higher rates will be necessary to cover Bonneville's deferred payments. FERC estimates that Bonneville already is behind on payments to the treasury by more than $1 billion, compared to a system of regular payments.

I believe a system of regular annual payments would protect the ratepayers and at the same time insure that the Federal taxpayers receive full repayment on the debt they are owed.

In previous testimony, FERC, GAO, Treasury, and the Grace Commission have all endorsed some type of regular repayment schedule for Bonneville.

I have introduced legislation, S. 2788, to accomplish that goal. My bill would instruct Bonneville to make annual payments to the Treasury sufficient to amortize the Federal debt. I believe that is the most sensible way to get that debt under control. I believe it is the only way and it is the only way to avoid a future default on such obligations. I look forward to comments on that proposal by today's witnesses on that proposal.

Nothing is going to happen in this session of Congress. That is obvious. But the issue is not going to go away and if we don't have the votes on Monday, we may have them on Tuesday, and if we don't have them on Tuesday, we will have them on Wednesday, and I say that figuratively, of course. At some point, Bonneville is going to have to repay the debts that it owes the Federal Government. And it will be far better if Bonneville came up with a proposal and a procedure as to how they are going to be repaid, rather than expect the entire Congress to come up with that solution.

I would like to say a word about my interest in this issue. Last year the default on bonds for WPPS plants 4 and 5 affected bondholders throughout the country. At that time, Senator McClure offered legislation on the subject. Now we are addressing the failure of Bonneville to make regular payments on its $7.9 billion debt to

the taxpayers of this country. In my opinion, all of those concerns make this a national issue, not just a regional concern.

I have been a long-time advocate of low utility rates in my State and I have supported that concept for people throughout the entire 50 States. I have no desire to increase the utility rates for Bonneville customers in the Northwestern States. My legislation would not increase consumer rates. It only requires an orderly, annual repayment of the existing Bonneville debt. My honest opinion is if you put this up to the people of the area and said to them, do you think we ought to be paid a debt that we owe the Federal Government, I have no doubt in my mind that they are law abiding citizens, that they would say, of course, we ought to repay it.

We teach our children an obligation to meet their commitments and to live up to their contracts and to do business in that manner and we certainly believe that we in the northwestern part of the United States have as much obligation to meet our commitments as anyone else.

The main question is will Bonneville's rates be sufficient to make those payments? I don't know the answer to that. But that is a decision for the Bonneville Power Authority to make. If Bonneville continues to postpone making payments on that debt, how will ratepayers be affected in later years? Does somebody think that somebody is going to go forward, as there is a proposal pending in the Congress at the moment, to forgive something like $8 billion in obligations owed by rural electrification cooperatives, to totally forgive it? What kind of government are we that we lend people money and then come to the Government and ask for forgiveness.

In all fairness, Bonneville has not done that at this moment, but neither have they come up with a proposal as to how they are going to meet their obligation.

Finally, despite growing consumer resistance to higher rates and reduced electricity demand in the Northwest, Bonneville apparently plans to commit itself through net billing agreements to complete construction of the WPPS plants 1 and 3. Are those plants really necessary? Is the power needed? Won't construction of those plants cause Bonneville to further increase its rates? And won't that make it even more difficult to repay the federal debt of $7.9 billion?

I believe these are all relevant questions. I look forward to hearing discussion on these issues in today's hearing. Today's hearings will not resolve this issue, but I say to you that at some point Congress will come to grips with this issue and as in so many other instances, when Congress does it on its own, quite often it is not nearly as good a job as if the involved parties themselves come up with a proper solution.

That I think is one of the main purposes of this hearing and that is for Bonneville to come up with its own solution rather than wait for Congress to mandate a solution.

Thank you.

Senator EVANS. Thank you, Senator Metzenbaum. I note that Senator Gorton is here and although not a member of this committee, he has always had a strong interest in this issue. Senator Gorton, do you have an opening statement?

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STATEMENT OF HON. SLADE GORTON, A U.S. SENATOR FROM THE STATE OF WASHINGTON

Senator GORTON. Thank you, Mr. Chairman, for this opportunity to participate in this hearing on the history and methodology of BPA's repayment of its obligation to the U.S. Treasury. I really appreciate this courtesy in view of the fact that I am not a member of the committee.

Chairman McClure and Acting Chairman Evans are to be commended for holding this oversight hearing. Although I understand that Bonneville has changed its procedures to address the major problems with respect to repayment that have been encountered over the last few years, it is still appropriate for the Congress to exercise its oversight responsibility in reviewing the present repayment system in determining whether or not there are methods by which improvements can be made.

In fact, Mr. Chairman, as you know, the BPA is about to make a deferred interest payment which will catch up on that deferred interest and hopes to be caught up on all deferred interest and amortization by the end of fiscal year 1985. This is a real tribute to the management of BPA in difficult times and to its Administrator, Peter Johnson.

One of the elements with respect to this entire problem which has been brought forcefully to our attention in the Pacific Northwest, and for that matter across the country in the course of the last few years, is that rate increases do not automatically increase the income of BPA or of other utilities. The demand for power is flexible and very frequently those rate increases have simply cut down on usage to the point at which the income of the utilities is no greater.

This is an extremely sensitive issue on both the rates, which our citizens pay, and the income which is received by the utilities related to these repayment schedules and to the ability of BPA to repay those obligations. The Senator from Ohio is no doubt facing exactly that same problem, as we deal with the question of acid rain and what is taking place in the Midwest at the cost of the eastern part of the United States.

I would be surprised if he would take the position that power costs should go up so much, enough in the Midwest to end that deposit of acid rain in New England.

Today's hearing will be an educational one for me and I expect for the members of the committee. I am confident that the Government witnesses appearing today will be able to provide us with some of the necessary background information which will help us to make prudent decisions with respect to BPA and its repayment schedule.

I look forward to working with my colleague from the State of Washington, my other colleague from the Pacific Northwest and with the Senator from Ohio to see whether or not there is a better way in which to meet these obligations which is responsible to our constituency.

Senator EVANS. Senator Ford, do you have any opening remarks?

Senator FORD. No. Mr. Chairman, I will try not to meddle in your business.

Senator EVANS. All right. Senator Hecht?

Senator HECHT. No, Mr. Chairman, no remarks.

Senator EVANS. Was there a message in that, Senator Ford?

Senator FORD. I believe the former attorney general of Washington got the message.

Senator EVANS. I will place in the record at this point a statement from Senator McClure and a statement from Senator Hatfield.

[The prepared statements of Senator McClure and Senator Hatfield follow:]

OPENING STATEMENT OF SENATOR MCCLURE
BPA OVERSIGHT HEARING
SEPTEMBER 13, 1984

MR. CHAIRMAN, I WOULD LIKE TO MAKE A FEW BRIEF OPENING REMARKS REGARDING BONNEVILLE'S REPAYMENT PERFORMANCE OVER THE PAST SEVERAL YEARS, WHICH ADMITTEDLY HAS NOT BEEN SATISFACTORY FROM THE STANDPOINT OF THE FEDERAL TREASURY. HOWEVER, IT IS IMPORTANT TO REMEMBER THAT BONNEVILLE OPERATES UNDER TWO PRIMARY DIRECTIVES IN SETTING RATES. FIRST, CONSISTENT WITH SOUND BUSINESS PRACTICE, RATES MUST BE DESIGNED TO COVER ANTICIPATED COSTS, INCLUDING REPAYMENT OF THE FEDERAL INVESTMENT. SECOND, RATES ARE TO BE SET AT THE LOWEST POSSIBLE LEVEL FOR THE CONSUMERS. THESE OBJECTIVES MAKE THE ALREADY DIFFICULT TASK OF TRYING TO PROJECT ELECTRIC LOADS AND RESULTING REVENUES EVEN MORE DIFFICULT. IF BPA ERRS TOO FAR ON THE SIDE OF PROVIDING A CUSHION OF REVENUES FOR UNEXPECTED EVENTS, RATEPAYERS CLAIM THAT THEY ARE BEING CHARGED UNNECESSARILY. IF BPA CUTS THE MARGIN TOO THIN, THEY ARE CHARGED WITH NOT RECOVERING COSTS.

OVER THE PAST TEN YEARS, THE PACIFIC NORTHWEST HAS BEEN A PARTICULARLY DIFFICULT REGION TO PROJECT IN TERMS OF ELECTRICAL GROWTH. RAPIDLY ESCALATING RATES AND THE EFFECT OF THE RECESSION ON THE ALUMINUM AND TIMBER INDUSTRIES HAVE MADE PROJECTIONS MORE ELASTIC THAN USUAL. I AM PLEASED, HOWEVER, THAT IN THE PAST 4 YEARS, UNDER THE DIRECTION OF PETER JOHNSON, BONNEVILLE HAS CONDUCTED ITSELF IN A MORE BUSINESS-LIKE, EFFICIENT MANNER. IT APPEARS THAT FINALLY THE REGION WILL AGAIN EXPERIENCE RELATIVE RATE STABILITY AND MORE PREDICTABLE GROWTH. AS A RESULT THIS YEAR, BONNEVILLE WILL MAKE UP ALL OF ITS DEFERRED INTEREST ON TREASURY OBLIGATIONS BY MAKING A PAYMENT OF $218 MILLION.

I AM LOOKING FORWARD TO THE TESTIMONY OF THE WITNESSES BEFORE THE COMMITTEE AND HAVE A NUMBER OF QUESTIONS WHICH I EXPECT TO ASK. IN A TIME WHEN BONNEVILLE AND THE REGION APPEAR TO BE GETTING BACK ON THEIR FEET, I AM NOT YET CONVINCED THAT THE INTERESTS OF THE NATION, THE U.S. TREASURY, OR THE REGION WILL BE SERVED BY IMPOSING A NEW STRICTER REPAYMENT POLICY ON BPA.

Statement of Senator Mark O. Hatfield
Before the Senate Energy and Natural Resources Committee on the
"Oversight Hearing of the Bonneville Power Administration's Repayment of Obligation to the U.S. Treasury"
September 13, 1984

Mr. Chairman, I want to thank you for holding this hearing today on a subject that is vitally important to the Northwest, and to the Nation.

Every region of the country has some unique resource or characteristic of value and, in the Northwest, the vast network of dams and reservoirs and high-voltage transmission lines have served to bring economic health to a vast area. Since the inception of this major system, the Northwest has been on a plan to repay the U.S. Government for the costs of these projects through rates collected by the Bonneville Power Administration. For nearly 50 years this repayment by the Northwest was accomplished and in most cases ahead of schedule.

In recent times, severe economic conditions of unanticipated duration and depth in the Northwest created shortfalls in BPA's revenues. This caused BPA to defer some of its normally scheduled interest payments for a period of years. The Appropriations Committee has carefully scrutinized these deferrals and monitored BPA budgets with concern that the plan for repayment be achieved.

BPA Administrator Peter Johnson appeared before the Energy and Water Subcommittee this Spring and presented a thorough review of BPA plans for repayment of Federal obligations. Mr. Johnson described conditions in the period during which BPA began deferring its repayment, conditions which saw the Northwest energy outlook turn dramatically from an anticipated shortage of electric energy to an electric energy surplus.

Mr. Johnson testified that he has instituted management controls to overcome and avoid these conditions in the future. His commitment to repayment was clear as he cited his actions to:

- Improve the forecasting to better guide financinal planning.
- Introduce flexibility into rate design to respond to unforeseen changing circumstances.
- Achieve effective control of Supply System costs.
- Take tough internal actions in BPA to control costs.
- Pursue vigorous marketing efforts for the nearterm surplus of power.

These steps have taken time to have their effect and Mr. Johnson has reiterated his management controls in successive budget reviews during 1982, 1983, and 1984. He has made specific commitments to the Senate Appropriations Committee to:

- Repay all deferred interest to the Treasury, and
- Make sizeable amortization payments -- both by the end of FY 1985.

The BPA actions are now producing results. The Administrator has just publicly announced payment of all deferred interest at the end of this month. This payment is greater than he discussed just this last April. I am confident that BPA will continue to fulfill these commitments for an orderly repayment to the Treasury by 1985 and into the future, so long as no further severe economic events or water shortages occur which are outside the realm of the agency to anticipate.

I believe the current situation with respect to BPA's repayment demonstrates the workability of the plans for repayment which were originally set in place. BPA requires the type of flexibility in the current methods to account for conditions outside agency control. At the same time, the public scrutiny, which I can assure you occurs in the appropriations process, protects the Federal interest in ultimate repayment.

The large rate increases by BPA in recent years have had significant impact on the foundations of the Northwest economy. Just last week, BPA announced the lowest rate increase in 10 years. BPA's preliminary rate proposal for 27 months beginning July 1, 1985, will be very near the rate of inflation. This is a major accomplishment toward stabilizing rates after years of dramatic rate increases. Any arbitrary actions related to repayment which would cause rapid and large increases in Northwest electricity rates would be severely damaging to the region's fragile economy.

I strongly believe that BPA has demonstrated that the current approach to repayment is consistent with Congressional intent, is consistent with DOE policy, and that proper payment to the Treasury will result.

Senator EVANS. Now, we are prepared to turn to our witnesses, and we are delighted to have, first, before us a very patient Representative Weaver from the State of Oregon, chairman of the Subcommittee on Mining Forest Management in the Bonneville Power Administration and the Committee on Interior and Insular Affairs in the U.S. House of Representatives.

Welcome, Representative Weaver. We are delighted to have you in front of us.

STATEMENT OF HON. JAMES WEAVER, A U.S. REPRESENTATIVE FROM THE STATE OF OREGON

Mr. WEAVER. Thank you very much, Mr. Chairman and Senators, I truly appreciate the opportunity and the courtesy you have provided me in allowing me to testify.

Mr. Chairman, this morning in a statement that has come to be all too typical of the Bonneville Power Administration, they announced that they would repay their late payment early. Not only is this statement ridiculous, it is not true. First, Bonneville in its fiscal year 1983 budget had promised to pay this deferred interest by the close of fiscal 1983. Thus, BPA's payment is now 1 full year later than expected.

Second, the BPA repayment study for fiscal year 1984 shows interest in $5 million repayment of principal at the end of fiscal year 1984, thus by paying off the deferred interest now, BPA has in no way accelerated its previous payment. We have heard of the dismal record of Bonneville's repayment of the Federal debt. We may not hear other witnesses today state the reasons for Bonneville's failure, the staggering cost of repayment of WPPS debt. Nor are you likely to hear from other witnesses a plan for ensuring reliable payment.

My plan, more detailed than I will state here, includes the immediate termination of WPPS 1 and 3, which would save nearly $100 million a year in preservation costs and also the creation of a board of directors, elected by the people of the Northwest to keep Bonneville's costs and obligations under the control of the people.

BPA has not been repaying the Federal investment, because it has been paying WPPS instead. Chart 1, Mr. Chairman, these are staggering figures that I, until developed by my counsel Dan Meek, I had no idea of, chart 1 shows the sharp growth in BPA revenue requirements since fiscal 1979, and by far the largest component of that growth has been BPA's interest payments in the Barnes' issue to finance WPPS 1, 2, and 3. See that chart, there is where your money has gone and why Bonneville has not repaid the Federal debt.

This chart does not include costs of payment on 4 and 5. Why did BPA have to increase its payments to WPPS so dramatically, because the Reagan-appointed BPA administrator, Peter Johnson, insisted upon approving an avalanche of WPPS bond sales during 1981 and 1982, long after various studies had concluded that these projects would cost more than the power would be worth and 6 years after I called for their termination.

In 1981 and 1982, BPA approved the issuance of 2.7 billion bonds for WPPS 1, 2, and 3 at record high tax exempt interest rates up to 15 percent. More than 1.8 billion of that went to WPPS 1 and 3, now mothballed.

Chart 2, and this really illustrates, chart 2 shows that the preponderance of debt for WPPS plants 1, 2, and 3 occurred in 1981 and 1982. In other words, had we stopped the plants in the spring of 1981, when almost everyone who knew anything about it knew that they were going to be worthless, Bonneville continued to obligate the people in the Northwest for two-thirds of the debt of the entire WPPS plant.

This amounts, if we take 10 percent foregone interest, the total cost to ratepayers over the next 30 years is over $63 billion just for the WPPS bonds issued in 1981 and 1982, $63 billion of repayment for the WPPS bonds issued in 1981 and 1982.

I would suggest, very respectfully suggest that you ask the Bonneville Power Administration who is going to come up with various wonderful scenarios if there is a shortfall in revenues and they have lowered their rates to the aluminum plants, and consumer usage of electricity in the Northwest has been falling for the last 10 years in spite of the increase in the economy, ask Bonneville who would come first in the case of a shortfall, the WPPS debt or the Federal debt.

Bonneville has only contempt for the will of the people. Why did Bonneville and WPPS fall into this frenzy of bond selling during late 1981 and 1982? They did so in order to circumvent the voters of the State of Washington, who in November 1981 by a 2-to-1 margin enacted initiative 394, which conditioned further bond sales upon a vote of the people to be saddled with the debt. This new law was scheduled to take effect on July 1, 1982, so BPA rushed to sell 2.3 billion of WPPS bonds during the 9 months from September 1981 through May 1982.

Not satisfied BPA, WPPS, and Wall Street then succeeded in having the Federal courts gut the initiative. In April 1983, the U.S. Supreme Court declined to consider the merits of initiative 394 because the attorney general of Washington refused to appeal the surprising decision of the Ninth Circuit Court of Appeals invalidating the initiative.

The people of Washington through the groups sponsoring the ballot measure did file an appeal. The Supreme Court ruled they had no standing.

As you know, Mr. Chairman, I held several hearings in which Peter Johnson appeared in this period 1981-82 pleading with him, urging him not to issue more bonds, because it would simply saddle the people in the Northwest with more debt and make it less likely that we could repay our Federal debt.

BPA spending is out of control. BPA produces its own budget, dominated by the cost of WPPS and then proceeds to spend it whatever way it chooses. In July 1981, without consulting any committee of Congress or the public BPA suddenly shelled out $102 million temporarily to prop up WPPS 4 and 5, on which it was not contractually obligated, but WPPS 4 and 5 had run out of money.

In fiscal year 1982, BPA overspent its planned WPPS budget by another $103 million. In fiscal year 1984, BPA spent at least $60 million more on WPPS 2 to misbudget it. With no controls on BPA outlays, it is not surprising that BPA has failed to repay the Federal debt. BPA now essentially has complete discretion to commit Northwest ratepayers to finance more billions of dollars for WPPS 1 and 3. No one in the Northwest can tell BPA to stop. Only 3 weeks ago, BPA and WPPS executed new agreements which require the ratepayers to pay all existing and future costs of WPPS, whether or not the Northwest utilities ever had legal authority to participate in the projects.

BPA can now spend another $4 billion or more on WPPS 1 and 3 in the face of the Northwest firm power surplus already expected to last for 10 years even without economical efforts of conservation.

My approach to ensuring repayment of Federal investment would not be to raise BPA rates, it would be to cut BPA costs. BPA spending must be determined by those expected to pay the bills, the ratepayers. Today my constituency is expected to pay for debt incurred without their consent, even though they exercise no control of BPA.

Repayment of the Federal investment can never be assured as long as BPA can fulfill its dream of spending even more money on WPPS. WPPS and BPA have already mortgaged the future earnings of the people of the Pacific Northwest and have helped drain the life from the region's economy. That is a very important point. You talk about no growthers, Mr. Chairman. The biggest no growther in the United States was the people who promoted and put through WPPS.

This according to Secretary of Energy Hodel, who appeared before my committee recently, caused, and this is his statement, he agreed that the WPPS had stifled the region's economic growth and that he himself had discouraged people from, industries from locating in the Northwest. Because even if WPPS now stops dead in its tracks, the Northwest will have to pay over $820 million per

year for the next 30 years for a total of $25 billion or with foregone interest of 10 percent a grand total of $135 billion over the next 30 years, a loss, a direct loss to the people of the Northwest. That is nearly $17,000 a resident or $70,000 for a family of four.

Mr. Chairman, repayment of BPA's Federal debt is a problem. WPPS is the cause. The solution is to allow the Northwest ratepayers to tell BPA to stop spending more money on WPPS 1 and 3. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Weaver follows:]

TESTIMONY OF REPRESENTATIVE JAMES WEAVER

Mr. Chairman and Members of the Committee:

Today you will no doubt hear about BPA's dismal record of repaying the federal investment in the electric power system of the Pacific Northwest. Since the Reagan Administration took office in 1981, BPA has repaid less than 1/40 of 1% of the total federal investment of nearly $8 billion. For the 6th consecutive fiscal year, BPA will again at the close of FY 1984 make essentially zero repayment of principal.

You will also hear that FY 1984 has indeed been a good year for BPA financially, and that BPA will pay off all of its $218 million of deferred federal interest, thus bringing BPA's actual repayment to the U.S. Treasury during the past 4 years back up to zero and leaving principal payments another 4 years behind.

What you probably won't hear from any other witness today is the underlying reason for BPA's failure: the staggering cost of WPPSS. Nor are you likely to hear anyone else propose a plan for ensuring reliable repayment. My plan includes:

1. The immediate termination of WPPSS 1 and 3, which would save nearly $100 million per year in "preservation" costs, and

2. Creation of a Board of Directors, elected by the people of the Pacific Northwest, responsible for selecting and removing the BPA Administrator and for determining BPA's budgets and rates in order to ensure repayment of the presently authorized federal investment.

BPA REPAYMENT HAS BEEN STYMIED BY THE ENORMOUS COST OF WPPSS.

BPA hasn't been repaying the federal investment, because it has been paying WPPSS instead. Chart 1 shows the sharp growth in BPA revenue requirements since FY 1979. By far the largest component of that growth has been BPA's interest payments on the bonds issued to finance WPPSS 1, 2 and 3, which now amount to about half of BPA's actual costs other than payments to the U.S. Treasury. And this chart does not include the additional $200 million annual debt burden for WPPSS 4 & 5, now in litigation.

Why did BPA have to increase its payments to WPPSS so dramatically? Because the Reagan-appointed BPA Administrator insisted upon approving an avalanche of WPPSS bond sales during 1981 and 1982, long after various studies had concluded that these projects would cost more than the power would be worth and 6 years after I called for their termination. In 1981 and 1982, BPA approved the issuance of $2.7 billion of

bonds for WPPSS 1, 2 and 3 at record high tax-exempt interest rates up to 15%. More than $1.8 billion of that went to WPPSS 1 & 3, now mothballed. Chart 2 shows that these bonds sold in 1981 and 1982 created 2/3 of the total debt burden for BPA's WPPSS projects--nearly $400 million per year for 30 years. This chart reminds me of the Reagan budget deficits. At 10% interest, the total total cost to ratepayers over the next 30 years amounts to over $63 billion just for these WPPSS bonds issued in 1981 and 1982.

If BPA had merely stopped approving bonds for WPPSS 1 & 3 in 1981, then more than 2/3 of the debt for these plants would not exist! BPA's annual outlays would have been reduced by $260 mill on per year for the next 30 years. Instead of fa.ling behind, BPA could by now have been years ahead of schedule in paying off the federal investment.

BPA HAS ONLY CONTEMPT FOR THE WILL OF THE PEOPLE.

Why did BPA and WPPSS fall into this frenzy of bond selling during late 1981 and early 1982? They did so in order to circumvent the voters of the State of Washington, who in November 1981 by a 2-1 margin enacted Initiative 394, which conditioned further bond

sales upon a vote of the people to be saddled with the debt. This new law was scheduled to take effect on July 1, 1982, so BPA rushed to sell $2.3 billion of WPPSS bonds during the 9 months from September 1981 through May 1982.

Not satisfied, BPA, WPPSS, and Wall Street then succeeded in having the federal courts gut the Initiative. In April 1983, the U.S. Supreme Court declined to consider the merits of Initiative 394, because the Attorney General of Washington (Ken Eikenberry, R) refused to appeal the surprising decision of the Ninth Circuit Court of Appeals invalidating the Initiative. The people of Washington, through the group sponsoring the ballot measure, did file an appeal, but the Supreme Court stated that they lacked "standing to appeal." Thus, the will of the people was completely and cavalierly disregarded, and BPA remains able to further indebt the people of the Northwest without their consent.

As you know, Mr. Chairman, I pleaded with the BPA Administrator not to approve these massive bond sales. I hoped and prayed that you, Senator McClure, and Senator Hatfield would join me in stopping Peter Johnson from heaping this huge additional debt on the

people of the Northwest. But you did nothing.

BPA SPENDING IS OUT OF CONTROL.

BPA produces its own budget, dominated by the cost of WPPSS, and then proceeds to spend in whatever way it chooses. In July 1981, without consulting any committee of Congress or the public, BPA suddenly shelled out $102 million to temporarily prop up WPPSS 4 & 5, which had run out of money. In FY 1982, BPA overspent its planned WPPSS budget by another $103 million. In FY 1984, BPA spent at least $60 million more on WPPSS 2 than was budgeted. With no controls on BPA outlays, it is not surprising that BPA has failed to repay the federal debt.

BPA now has essentially complete discretion to commit Northwest ratepayers to finance more billions of dollars for WPPSS 1 & 3. No one in the Northwest can tell BPA to stop. Only 3 weeks ago, BPA and WPPSS executed new agreements that require the ratepayers to pay all existing and future costs of WPPSS, whether or not the Northwest utilities ever had legal authority to participate in the projects. BPA can now spend another $4 billion or more on WPPSS 1 & 3 in the face of a Northwest firm power surplus already expected to last

for 10 years even without economical efforts at conservation.

THOSE EXPECTED TO PAY SHOULD CONTROL BPA SPENDING.

My approach to ensuring repayment of the federal investment would not be to raise BPA rates: it would be to cut BPA costs. BPA spending must be determined by those expected to pay the bills--the ratepayers.

Today my constituents are expected to pay for debt incurred without their consent, even though they exercise no control of BPA. Repayment of the federal investment can never be assured as long as BPA can fulfill its dream of spending even more money on WPPSS.

WPPSS and BPA have already mortgaged the future earnings of the people of the Pacific Northwest and have helped drain the life from the region's economy. Even if WPPSS now stops dead in its tracks, the Northwest will have to pay over $820 million per year for the next 30 years--a total of $25 billion or, with foregone interest at only 10%, a grand total of $135 billion over the next 30 years. That's nearly $17,000 per resident, or almost $70,000 for a family of four.

At hearings before my Subcommittee last month,

Secretary of Energy Donald Hodel, who as the BPA Administrator started the WPPSS debacle, stated that in the 1970s he discouraged businesses from locating in the Northwest because of imagined power shortages. He agreed that the same mentality that devised WPPSS also stifled the region's economic growth. Now that mindset has left a legacy of debt and default that will plague the Northwest for yet another generation.

Mr. Chairman, repayment of BPA's federal debt is a problem. WPPSS is the cause. The solution is to allow the Northwest ratepayers to tell BPA to stop spending more money on WPPSS 1 & 3.

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CHART 1

BPA REVENUE REQUIREMENTS

Not Including Federal Interest or Repayment

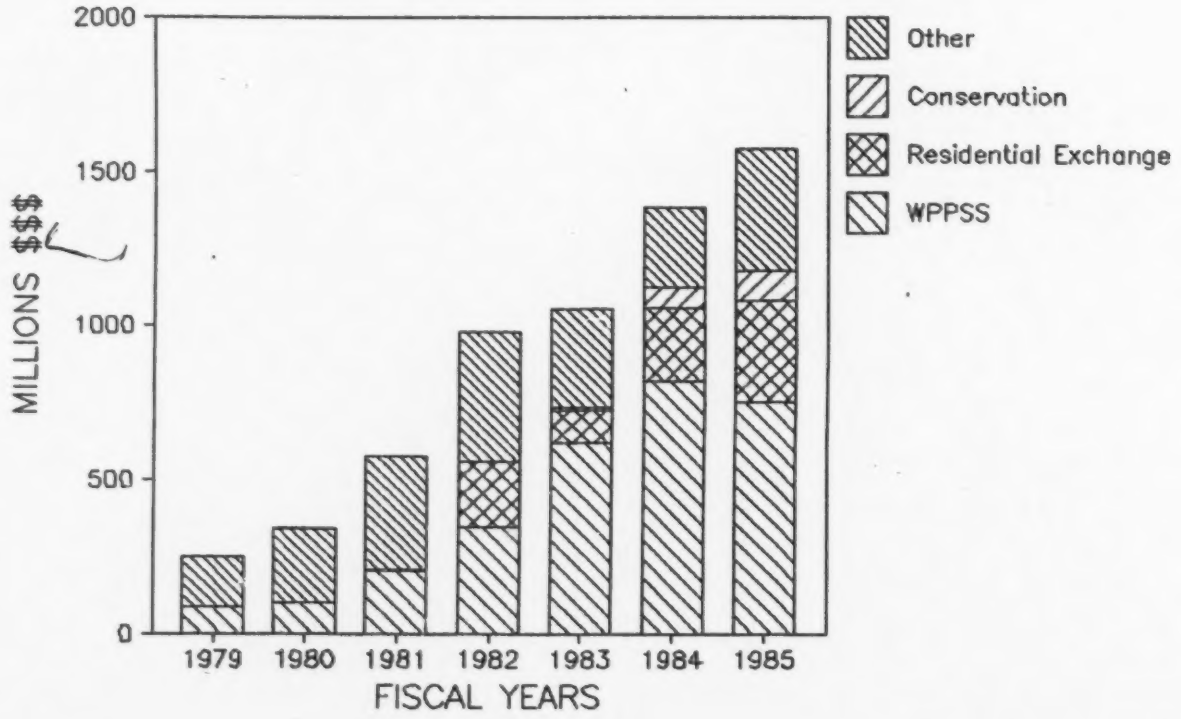
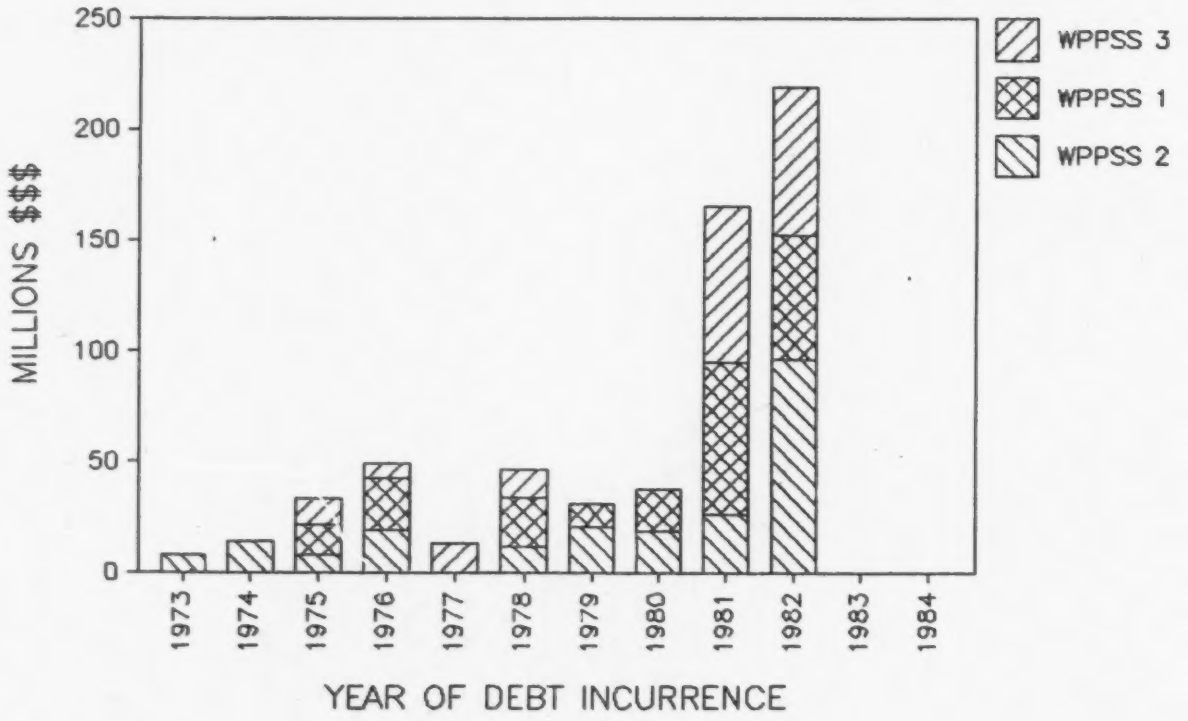


CHART 2

BPA–APPROVED WPPSS 1–3 DEBT BURDEN

ANNUAL 30–YEAR INTEREST OBLIGATION IMPOSED



Senator EVANS. Thank you, Representative Weaver. Are there questions from members of the committee?

Senator Metzenbaum.

Senator METZENBAUM. I have just a couple. Congressman, of the bonds that were issued in, I guess it was 1981 or 1982, did they use all of the money? Has it all been spent?

Mr. WEAVER. Yes, to my knowledge, all committed and spent, because Bonneville has had to come up with more out of ratepayers' money itself.

Senator METZENBAUM. And that was spent for 1 and 3, which are partially built?

Mr. WEAVER. A large part of it was spent on 1 and 3, sir.

Senator METZENBAUM. Are they still building 1 and 3?

Mr. WEAVER. They are mothballed, but they cost about $100 million a year to preserve in that state. If that were stopped, then we could use that $100 million to repay the Federal debt. Of course, Bonneville will tell you it will cost money to terminate the plants and I am sure it will, but that is going to come anyway some day.

Senator METZENBAUM. It costs a $100 million just to keep 1 and 3 mothballed?

Mr. WEAVER. Yes, sir; and besides this, sir, Bonneville is making direct payments on 4 and 5, on which they have no contractual obligation to do so, but they have come up with $25 million to Western Nuclear. They have come up with other millions to buy outdated nuclear fuel at yesterday's prices. They have put all kinds of millions of dollars, billions of dollars, of course, into these plants, even after they have been mothballed or terminated.

Senator METZENBAUM. I have no further questions. Thank you.

Senator EVANS. Senator Ford.

Senator FORD. No, thank you.

Senator EVANS. Senator Gorton, we would be delighted to have you participate.

Senator GORTON. Thank you.

Senator EVANS. There are no further questions. We thank you.

Mr. WEAVER. Thank you.

Senator EVANS. I would like to call the next witnesses together as a panel and we will go in order through their testimony and we will be prepared then to ask questions of all of them. We have the Honorable Peter Johnson, Administrator of the Bonneville Power Administration; accompanied by Stephen Ailshie, Assistant Administrator of Financial Management; the Honorable Thomas Healey, Assistant Secretary of Treasury for Domestic Finance, U.S. Department of Treasury; the Honorable Daniel C. Lamke, special assistant to the general counsel of the Federal Energy Regulatory Commission; and the Honorable Kevin Boland, senior associate director for the General Accounting Office.

Welcome, gentlemen, and we will start with Peter Johnson, the Administrator of the Bonneville Power Administration.

Senator METZENBAUM. Mr. Chairman, I wonder whether we could ask the witnesses to give us abbreviated summaries of their statements rather than each of them reading them, since there are five witnesses, whether they could not tell us in a nutshell what their position is, rather than having them—we can all read their statements in full.

Senator EVANS. I think it would be useful to at least use as much detail as is necessary to set the stage. It is a complex and difficult issue and so to ensure that the audience as well as the members have a fundamental understanding of what we are talking about, so if you can try to be brief but complete.

Peter.

STATEMENT OF HON. PETER T. JOHNSON, ADMINISTRATOR, BONNEVILLE POWER ADMINISTRATION, ACCOMPANIED BY STEPHEN A. AILSHIE, FINANCIAL MANAGER, BONNEVILLE POWER ADMINISTRATION

Mr. JOHNSON. Thank you, Mr. Chairman, and I will attempt to respect that wish. I will attempt to make this as brief as possible. We are dealing with a very important subject and so I will work from my prepared comments.

Members of the Senate Energy and Natural Resources Committee, ladies and gentlemen, I would like to thank you for the opportunity to participate in this oversight hearing concerning the Bonneville Power Administration's repayment practices.

As Administrator of the Bonneville Power Administration, I am here to testify on BPA's financial commitment and its responsibilities in repaying the investment in the Federal Columbia power system. I am accompanied by BPA's financial manager, our chief financial officer, Mr. Stephen Ailshie.

In the following brief overview, I will describe BPA's functions and responsibilities as a Federal power marketing agency, the statutes under which we operate, and our strong commitment to the agency's responsibilities, including our commitment to repay the Federal investment in the Federal Columbia power system.

Bonneville is the Federal electric power marketing agency in the Pacific Northwest, a 300,000-square-mile service area that encompasses Oregon, Washington, Idaho, and western Montana. BPA markets hydroelectric power from 30 U.S. Corps of Engineers and Bureau of Reclamation projects as well as non-Federal hydro and thermal energy from certain generating facilities within the region. BPA markets and exchanges electric power interregionally over the Pacific Northwest-Pacific Southwest Intertie and with Canada over interconnections with utilities in British Columbia.

Bonneville constructs, maintains, and operates the Nation's largest high-voltage transmission system grid. This permits the coordination of the Federal electric power program with the region's public and private investor-owned utilities to obtain the operating economies and investment benefits of a single regionwide utility. The Federal generating resources and BPA's transmission system are operated as an integrated power system with operating and financial results combined and reported as the FCRPS.

Under the Bonneville Project Act of 1937, BPA was authorized to develop rate schedules to recover the cost of producing and transmitting electric energy and to amortize the capital investment over a reasonable period of years. Transmission system and construction was authorized to be financed through congressional appropriations.

In 1974, the Federal Columbia River Transmission System Act placed BPA on a self-financed basis and brought it under the provisions of the Government Corporation Control Act, giving BPA the flexibility necessary to fulfill its regional utility mission in a businesslike manner.

The Transmission System Act authorized BPA to use its operating receipts and proceeds from the sale of bonds to the U.S. Treasury to finance futher construction of the Federal transmission system in the Pacific Northwest. BPA has ongoing revolving fund authority to finance its operations with revenues from its power sales and other sources. In exchange for continuity of funding and the autonomy provided by the provisions of the Transmission System Act, the region's ratepayers paid the Treasury a rate comparable to AAA utility rates.

In 1980, with passage of the Pacific Northwest Electric Power Planning and Conservation Act, BPA's role and responsibilities were greatly expanded, as explained by Chairman Evans. BPA is now responsible for meeting the net firm power requirements of BPA's requesting customers and has authority to invest in energy conservation and to acquire other resources to meet these requirements.

The Northwest Power Act expanded BPA's borrowing authority under the Transmission System Act to allow U.S. Treasury financing for implementation of these conservation measures, renewable resources, and the enhancement of fish and wildlife. These borrowings must be repaid by the Bonneville Administration's ratepayers. Also, the rate paid on Treasury borrowings was changed to be comparable to Government corporation rates.

As required by authorizing legislation, Bonneville must recover the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of Federal investment in the Federal Columbia River power system over a reasonable period of years. In doing so, under law, we must also operate in a manner which encourages the most widespread use of electric power at the lowest possible rates to consumers consistent with sound business principles.

Due to Bonneville's expanded mission in the region, our annual revenues have grown by more than 500 percent since 1980. Rates to generate these revenues are determined after extensive public hearings in which all parties have a full opportunity to present written and oral testimony on proposed rate adjustments.

Before BPA's rates can be applied, they must be confirmed and approved by the Federal Energy Regulatory Commission. The Commission reviews all the studies used by Bonneville to establish its rates, including BPA's repayment study, and grants rate approval only if it finds that BPA's proposed rates "are sufficient to assure repayment of the Federal investment in the Federal Columbia River Power System."

During the recent troubled period for the regional and national economy, we have chosen to meet our many challenges with, one, an emphasis on long-term planning; two, fiscal integrity; and, three, a sensitivity to the needs of the region while adhering to our statutory responsibilities as a Federal agency.

Given regional economic uncertainty and the uncertainties of operating a predominantly hydroelectric system heavily dependent upon natural streamflows, we have implemented policies to ensure our fiscal integrity, which includes repayment of the Federal investment.

At my first opportunity in February 1983 at the Energy and Water Development Subcommittees of the House and Senate Appropriations Committees, I committed to a plan to make total repayment, including repayment of defersed interest to the Treasury by the end of fiscal year 1985. Slack power sales slowed our pace initially. However, we did not abandon our repayment goals and they are reflected in the wholesale power and transmission rates approved by the Commission on an interim basis on October 26, 1983 and in January 1984, respectively.

In March 1984, before the Energy and Water Development Subcommittees of both the House and the Senate Appropriations Committees, I reiterated my commitment to make full repayment of deferred interest on Treasury borrowings, plus a sizable amortization payment, by the end of fiscal year 1985.

Despite the continued slow economic recovery in the Pacific Northwest and uncertain power demand from one of our largest customer groups, we remain confident that our obligations will be met. On September 30, 1984, roughly a month from now, BPA will pay all current obligations, plus repay the entire outstanding interest deferral of $218 million. In addition, at the end of fiscal year 1985, Bonneville plans to make an amortization payment in the range of $226 million as promised, unless a major economic or a natural catastrophe descends upon us.

Our commitment to fiscal integrity remains strong. We have met our challenges and have implemented corrective measures to assure that timely repayments of the Federal investment will be made.

At this time, I would like to introduce BPA's financial manager, Mr. Stephen Ailshie, who will address, one, the laws and regulations which govern BPA's current repayment procedures; two, the current status of repayment; and, three, the outlook for repayment in light of BPA's previously stated repayment goals.

I will be happy to answer questions of members of the committee.

Thank you.

[The prepared statement of Mr. Johnson follows:]

STATEMENT OF PETER T. JOHNSON, ADMINISTRATOR, BONNEVILLE POWER ADMINISTRATION

Members of the Senate Energy and Natural Resource Committee, ladies and gentlemen, I would like to thank you for the opportunity to participate in this Oversight Hearing concerning the Bonneville Power Administration's repayment practices.

As Administrator of the Bonneville Power Administration (BPA), I am here to testify on BPA's financial commitment and responsibilities in repaying the investment in the Federal Columbia River Power System (FCRPS). I am accompanied by BPA's Financial Manager, Stephen A. Ailshie.

In the following brief overview, I will describe BPA's functions and responsibilities as a Federal power marketing agency, the statutes under which we operate, and our strong commitment to the agency's responsibilities, including our commitment to repay the Federal investment in the FCRPS.

BPA is the Federal electric power marketing agency in the Pacific Northwest, a 300,000-square-mile service area that encompasses Oregon, Washington, Idaho, and western Montana. BPA markets hydroelectric power from 30 U.S. Army Corps of Engineers (Corps) and U.S. Bureau of Reclamation (Bureau) projects, as well as non-Federal hydro and thermal energy from certain generating facilities in the region. BPA markets and exchanges electric power interregionally over the Pacific Northwest-Pacific Southwest Intertie, and with Canada over interconnections with utilities in British Columbia.

BPA constructs, maintains, and operates the nation's largest high-voltage transmission system grid. This permits the coordination of the Federal

electric power program with the region's public and investor-owned utilities to obtain the operating economies and investment benefits of a single regionwide utility. The Federal generating resources and BPA's transmission system are operated as an integrated power system with operating and financial results combined and reported as the FCRPS.

Under the Bonneville Project Act of 1937 [16 U.S.C. §832], BPA was authorized to develop rate schedules to recover the cost of producing and transmitting electric energy and to amortize the capital investment over a reasonable period of years. Transmission system and construction was authorized to be financed through Congressional appropriations.

In 1974, the Federal Columbia River Transmission System Act (the Transmission System Act) [16 U.S.C. §838], placed BPA on a self-financed basis and brought it under the provisions of the Government Corporation Control Act, giving BPA the flexibility necessary to fulfill its regional utility mission in a businesslike manner. The Transmission System Act authorized BPA to use its operating receipts and proceeds from the sale of bonds to the U.S. Treasury to finance further construction of the Federal transmission system in the Pacific Northwest. BPA has ongoing "revolving fund" authority to finance its operations with revenues from its power sales and other sources. In exchange for continuity of funding and the autonomy provided by the provisions of the Transmission System Act, the region's ratepayers paid the Treasury a rate comparable to AAA utility rates.

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In 1980, with passage of the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act) [16 U.S.C. §839], BPA's role and responsibilities were greatly expanded. BPA is now responsible for meeting the net firm power requirements of BPA's requesting customers and has authority to invest in energy conservation and to acquire other resources to meet these requirements. The Northwest Power Act expanded BPA's borrowing authority under the Transmission System Act to allow U.S. Treasury financing for implementation of these conservation measures, renewable resources, and enhancement of fish and wildlife. These borrowings must be repaid by BPA's ratepayers. Also, the rate paid on Treasury borrowings was changed to be comparable to government corporation rates.

As required by authorizing legislation, BPA must recover the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of Federal investment in the FCRPS, over a reasonable period of years. In doing so, under law, we must also operate in a manner which encourages the most widespread use of electric power at the lowest possible rates to consumers consistent with sound business principles. Due to BPA's expanded mission in the region, our annual revenues have grown by more than 500 percent since 1980. Rates to generate these revenues are determined after extensive public hearings in which all parties have a full opportunity to present written and oral testimony on proposed rate adjustments.

Before BPA's rates can be applied, they must be confirmed and approved by the Federal Energy Regulatory Commission (the Commission). The Commission reviews

all the studies used by BPA to establish its rates, including BPA's repayment study, and grants rate approval only if it finds that BPA's proposed rates "are sufficient to assure repayment of the Federal investment in the" FCRPS.

During the recent troubled period for the regional and national economy, we have chosen to meet our many challenges with an emphasis on long-term planning, fiscal integrity, and a sensitivity to the needs of the region while adhering to our statutory responsibilities as a Federal agency. Given regional economic uncertainty and the uncertainties of operating a predominantly hydroelectric system heavily dependent upon natural streamflows, we have implemented policies to ensure our fiscal integrity, which includes repayment of the Federal investment.

At my first opportunity in February of 1983 at the Energy and Water Development Subcommittees of the House and Senate Appropriations Committees, I committed to a plan to make total repayments, including repayment of deferred interest, to the Treasury by the end of fiscal 1985. Slack power sales slowed our pace initially. However, we did not abandon our repayment goals, and they are reflected in the wholesale power and transmission rates approved by the Commission on an interim basis on October 26, 1983 and January 27, 1984, respectively.

In March of 1984, before the Energy and Water Development Subcommittees of both the the House and Senate Appropriations Committees, I reiterated my commitment to make full repayment of deferred interest on Treasury borrowings, plus a sizeable amortization payment, by the end of fiscal 1985.

Despite the continued slow economic recovery in the Pacific Northwest and uncertain power demand from one our our largest customers groups, we remain confident our obligations will be met. On September 30, 1984, BPA will pay all current obligations plus repay the entire outstanding interest deferral of $218 million. In addition, at the end of fiscal 1985, BPA plans to make an amortization payment of at least $226 million as promised, unless a major economic or natural catastrophe descends upon us.

Our commitment to fiscal integrity remains strong. We have met our challenges and have implemented corrective measures to assure that timely repayments of the Federal investment will be made.

At this time, I would like to introduce BPA's Financial Manager, Stephen A. Ailshie. Mr. Ailshie will address:

1) the laws and regulations which govern BPA's current repayment procedures;

2) the current status of repayment; and

3) the outlook for repayment in light of BPA's previously stated repayment goals.

We would be pleased to answer any questions you may have.

STATEMENT OF STEPHEN A. AILSHIE, FINANCIAL MANAGER, BONNEVILLE POWER ADMINISTRATION

Mr. AILSHIE. Thank you. I will also try to brief down the prepared statement. However, it is a fairly complex subject and I would like to be sure we cover the material as completely as possible.

BPA is required to set its power and wheeling rates to recover the cost associated with the acquisition, conservation and transmission of electric energy. The adequacy of the revenues yielded by BPA's rates is determined by a repayment study. This study is required by section 2 of Public Law 89-448, which requires BPA to submit a repayment study annually to the Congress and the President.

The repayment study is included in the revenue requirement study, which is an integral component of BPA's rate filing process. If this study shows that BPA will not recover its costs within the rate period prescribed by law, BPA must take prompt action to adjust its rates to the extent necessary to meet its legal obligations.

Through the use of BPA's repayment methodology, BPA plans on making amortization payments on or before the associated project due dates, in order to levelize costs and to ensure funds are available to make payments in the future. The DOE repayment policy allows BPA to have sufficient flexibility to meet its overall obligations during periods when costs are greater than projected and when revenues are less than projected.

The need for this flexibility was recognized by Congress in a House committee report for the Grand Coulee Dam third powerplant authorization in 1966. In that report, there was a clear concern expressed that BPA would have flexibility to meet the extremes of, and I am quoting, "weather conditions, stream flows, current economic conditions, changing markets and the absorption of new projects into the system."

Recognition of the need for flexibility was further highlighted by a provision in the Pacific Northwest Electric Planning, Power Planning, and Conservation Act, which calls for an interest rate penalty on current borrowing, should the BPA be unable to meet its projected interest and amortization payments due to forces within its control. Although extensive use was made of this flexibility during the energy and economic problems of the seventies, Bonneville has taken corrective actions that will greatly reduce the probability to which this flexibility would be required in 1984 and future years.

BPA does prepare a schedule for the period in which each of the specific investments must be amortized. Investments must be repaid by the end of their average service lives or within 50 years, whichever is less. With respect to this schedule, BPA has always repaid the principal amounts within that required period.

BPA's payment policy was established during the preparation of the basic statutory requirements. I have attached a summary of those requirements to this statement and consistent with those requirements, DOE guidelines were developed to provide a methodology and provide guidance on the application of accounting proce-

dures. BPA currently follows this policy as it is set forth in DOE Order RA-6120.2

Now, in accordance with this policy, and I depart a little here from the prepared text, we are looking at a question of whether we are dealing with a repayment of a fixed debt or whether we are dealing with an equity position by the Federal Government. As we go through the priorities of these payments, we see that reflected in this particular situation.

In accordance with that order, revenues are applied first to pay the cost of operation, purchase power and then the interest and amortization of bonds. All of the remaining revenues are applied to repay the capital investment in prior facilities and irrigation assistance, as it falls due. In the repayment study, we are looking at the repayment of these items, the transmission plant which is scheduled to be repaid the 45th year after it is invested and the 50th year for generation, unless there is a different time period prepared, specified by statute.

BPA rates are established based on these calculations that are made and the rates must be confirmed and approved by the Federal Energy Regulatory Commission. Since 1939, BPA has repaid $638 million of the total principal. We believe that the $638 million is a significant amount when compared to the timing of BPA initial investments. Over 50 percent of the total investment of $7.7 billion in the Federal Columbia River Power System has occurred in the last 10 years.

Of course, there is no question that the last 9 years have been difficult ones for BPA. During this period BPA has had to defer $218 million in interest payments to the U.S. Treasury. However, we did pay interest on the deferred interest during that period of time. During that 9-year period, we were able to repay only $42 million of the outstanding Federal investment.

There were several factors that contributed to that. Foremost was our inability to raise rates between 1974 and 1979, during a period of unexpectedly high inflation and large real cost increases, including the impact of the supply system plants.

In addition, until recently, BPA had used regional estimates of load growth, that had exceeded actual experiences. Estimates during this troubled time were approximately 6 percent per year. These estimates were consistent with national forecasts and at that time they seemed prudent and reasonable.

Actual load growth, however, averaged only 1.9 percent. Finally, successive economic recessions between 1980 and 1981 and then again between 1982 and 1983 seriously hampered our revenue producing ability. Fiscal year 1984 has been a better year. We will be able to repay the entire $218 million of deferred interest, plus all newly accrued interest expense and operation and maintenance expense. We also fully expect to be able to meet our obligation of $226 million toward the Federal investment at the end of fiscal year 1985.

We have taken many steps to stabilize our costs. We feel that with the implementation of the new rates that we are announcing at the present time that we would plan to make cumulative payments of about $1.3 billion by the end of fiscal year 1987.

BPA has a strong commitment to fiscal integrity. We have taken several corrective measures to assure that repayments to the Federal investment will be made in a timely fashion, consistent with the current DOE repayment policies and we have overcome the problems and concerns which have been expressed in various reports and hearings during the past 3 years.

We are meeting our obligations for recovering costs and we are planning on making appropriate repayment.

I have several charts which we are interested in getting into as we get into the questions, Senator. I will be glad to go through those with you.

STATEMENT OF STEPHEN A. AILSHIE, FINANCIAL MANAGER, BONNEVILLE POWER ADMINISTRATION

Introduction

I'd like to thank you for the opportunity to provide you with an overview of Bonneville Power Administration's (BPA) repayment practices and our repayment status.

BPA is required to set its power and wheeling rates so as to recover the costs associated with the acquisition, conservation, and transmission of electric energy. The adequacy of the revenues yielded by BPA's rates is determined by a "repayment study."

The preparation of a repayment study is required by Section 2 of Public Law 89-448 (80 Stat 200) which requires BPA to submit a repayment study annually to the President and the Congress. The repayment study is included in the Revenue Requirement Study which is an integral component of BPA's rate filing process. If this study shows that BPA will not recover its costs within the period prescribed by law, BPA must take prompt action to adjust its rates to the extent necessary to meet its legal obligations.

Through the use of DOE's repayment methodology, BPA plans on making amortization payments on or before the associated project due dates in order to levelize costs and to ensure that funds are avai able to make payments in the future. The DOE's repayment policy allows BPA to have sufficient flexibility to meet its overall obligations during periods when costs are greater than projected and when revenues are less than projected. The need

for this flexibility was recognized by Congress in the House Committee Report for the Grand Coulee Dam Third Powerplant authorization in 1966 [H.R. No. 1409, 89th Congress, 2d Session P. 10 - Public Law 89-448]. In that report a clear concern was expressed for BPA to have flexibility to meet the extremes of "weather conditions, streamflows, current economic conditions, changing markets, and the absorption of new projects into the system." Recognition of the need for flexibility was further highlighted by a provision in the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act) (Section (8)(D)(4) Public Law 96-501) which calls for an interest rate penalty on current borrowing should the BPA be unable to meet its projected interest and amortization payments due to forces within its control.

Although extensive use was made of this flexibility during the energy and economic problems of the 1970's, Bonneville has taken corrective actions that will greatly reduce the probability to which this flexibility would be required in 1984 and future years. BPA does prepare a schedule for the period in which each of the specific investments must be amortized. Investments must be repaid by the end of their average service lives or within 50 years, whichever is less. With respect to this specific schedule, BPA has always repayed the principal amounts within the required period. In order to ensure that investments are repaid by the end of this required period, BPA must schedule all of its payments in such a manner that some payments are made before their due dates. Also, while scheduling payments on hundreds of investments which have different interest rates and different due dates, BPA

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has followed DOE's repayment policy, which permits BPA to repay its highest interest rate bearing obligations first.

BPA's repayment policy has been established through administrative interpretation of the basic statutory requirements. A summary of the statutory requirements is provided as an attachment to my statement. Consistent with the statutory requirements, DOE guidelines were developed to provide a basic payment methodology and to provide technical guidance on the application of accounting procedures. BPA currently follows the repayment policy for power marketing agencies set forth in DOE Order RA 6120.2. BPA followed this same policy (DM Part 730 Chapter 4) when it was part of the Department of the Interior before being transferred to DOE in 1977.

In accordance with DOE Order RA 6120.2, revenues are applied first to pay the costs of purchased power, operation, maintenance, and interest and amortization of bonds. All remaining revenues are applied to repay the capital investment in power facilities and irrigation assistance as it falls due. In the repayment study, appropriations invested in transmission plant are scheduled to be repaid by the 45th year after the associated transmission plant goes into service, and by the 50th year for generation, unless another time period is specified by statute. Bonds currently sold by BPA to the Treasury have 35-year maturities for transmission plant and 20-year maturites for conservation expenditures. Both have 5-year call provisions. The call provision prevents BPA from redeeming the bond before the end of the call period. Bonds are repaid according to the provisions of each bond contract.

Based on all of these constraints, the repayment program calculates and minimizes interest expense while establishing a hierarchy of scheduled amortization, assuring the lowest revenue requirement needed to repay all Federal Columbia River Power System costs.

BPA rates must be confirmed and approved by the Federal Energy Regulatory Commission (Commission). The review of the Commission, under Section 7 of the Northwest Power Act is limited to confirming or rejecting a BPA proposed rate. Before the Commission was created, this was the responsibility of the Federal Power Commission (FPC), which was succeeded by the Commission by the DOE Organization Act. The Commission can approve BPA's rates only if it makes a finding that BPA's proposed rates

> ". . . are sufficient to assure repayment of the Federal investment in the Federal Columbia River Power System over a reasonable number of years after first meeting the Administrator's other costs." 16 U.S.C. §839.

Since 1939 BPA has repaid $638 million of the total principal. We believe the $638 million repayment of the Federal investment to date is a significant amount when compared to the timing of BPA initial investments. Approximately 50 percent of the total Federal investment of $7.7 billion in the FCRPS has occurred in the last 10 years.

Under the current repayment policy, BPA has never been in arrears on the

Federal investment in the FCRPS. In fact, by the end of FY 1983, BPA had repaid $626 million before the required due dates associated with the Federal investments in the FCRPS.

Of course, there is no question that the last 9 years have been difficult ones for BPA. During this period BPA has had to defer $218 million in interest payments to the U.S. Treasury, however, we paid interest on this deferred interest. During that 9 years period we were able to repay only $42 million of the outstanding Federal investment. Several factors have contributed to BPA's financial difficulties during this period. Foremost was BPA's inability to raise its rates between 1974 and 1979 during a period of unexpectedly high inflation and large real cost increases including the impact of WNP-1 and -2, and 70 percent of -3. In addition, until recently, BPA has used Regional estimates of load growth that have exceeded actual experences. Estimates during this troubled time were approximately 6 percent per year. These estimates were consistent with National forecasts and at the time seemed prudent and reasonable. Actual load growth during this period, however, averaged only 1.9 percent. In fact, loads actually declined more than 8 percent between July of 1983 and July of 1983. Also a severe drought occurred in 1977, compounded by a low water year in 1979, greatly affecting the FCRPS's ability to generate power. Finally, successive economic recessions between 1980 and 1981 and then again between 1982 and 1983, seriously hampered BPA's revenue producing ability in the subsequent two rate cases.

Fiscal year 1984 has been a better year for BPA. BPA will be able to repay

its entire $218 million of deferred interest plus all newly accrued interest expense and operation and maintenance expense. BPA also fully expects to meet its obligations in FY 1985 including a $226 million payment towards the outstanding Federal investment.

We have taken many actions to stablize our revenues and costs over the past 2 years and are now monitoring these actions closely. We will make efforts to continue to improve our record of forecasting revenues and costs. These actions will help ensure that planned payments to the Treasury are made. We have developed new rate design features to help stablize our revenues. An increased emphasis has been placed on our financial management practices, including improved financial analyses, data gathering, and reporting techniques. Tighter budget and costs control measures have also been implemented. Finally, we have improved our ratemaking process by filing for rates on a more frequent basis which allows us to make more timely adjustments for unanticipated economic swings, using more sophisticated load forecasting techniques, new investment financing techniques, implementing automatic adjustment clauses for the Supply System Plants and the exchange costs, and adding incentive rates for the Direct Service Industries.

Currently, BPA is beginning its public involvement process on a rate adjustment to take effect in FY 1985. With the implementation of the new rates, BPA plans to make cumulative repayments of about $1.3 billion by the end of FY 1987. Significant amortization payments of about $223 million are planned in FY 1986 and another $250 million in FY 1987. BPA's initial rate

proposal is subject to change, but it provides a good indication of the magnitude of the amortization payments BPA is scheduling to ensure repayment of the Federal investment on schedule. BPA anticipates making significant amortization payments to the U.S. Treasury throughout the remainder of this century and well into the next.

BPA has a strong commitment to fiscal integrity. We believe we have taken corrective measures necessary to assure that repayments of the Federal investment will be made in a timely fashion, consistent with current DOE repayment policies. We have overcome the problems and concerns which have been expressed in various reports and hearings during the past few years. We are now meeting our obligations for recovering costs and we will be making the appropriate repayments. This concludes my prepared remarks. We would be pleased to answer any questions.

ATTACHMENT FOR STEVE AILSHIE"S STATEMENT

FOR SEPTEMBER 13, 1984, HEARING

BPA operates under the following laws to ensure that the revenues levels it sets are sufficient to fully recover costs:

Bonneville Project Act of 1937, (Public Law 88-552) (Section 7)

> "Rate schedules shall be drawn having regard to the recovery (upon the basis of the applications of such rate schedules to the capacity of the electric facilities of the Bonneville project) of the cost of producing and transmitting such electric energy, including the amortization of the capital investment over a reasonable period of years."

Flood Control Act of 1944 (Public Law 90-483) (Section 5). This Act provides that electric energy be marketed:

> ". . . in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles. . . ."

Third Power Plant Grand Coulee Dam Act of 1966 (Public Law 89-448): House Report No. 1409 Pages 9 and 10:

> ". . . there is no annual schedule of capital repayment. The test of the sufficiency of revenues is whether the capital investment can be repaid within the overall repayment period established for each power project, each increment of investment in the transmission system, and each block of irrigation assistance. Hence, repayment may proceed at a faster or slower pace from year to year as conditions change. Annual operating costs and revenues, of course, may vary from year to year, as they are affected by extremes of weather conditions, streamflows, current economic conditions changing markets, and the absorption of new projects into the system. This approach to repayment scheduling has the effect of averaging the year-to-year variations in costs and revenues over the repayment period. This results in a uniform cost per unit of power sold and permits the maintenance of stable rates for extended periods."

Federal Columbia River Transmission System Act of 1974 (Public Law 93-454) (Section 9) (Transmission System Act): This Act, which placed BPA on a "self-financing" basis by authorizing the use of revenues from the sale of electric power, wheeling charges and revenues bonds proceeds to finance BPA programs, further provides that rates be set:

> ". . . at levels to produce such additional revenues as may be required, in the aggregate with all other revenues of the Administrator, to pay when due the principal of, premiums, discounts, and expenses in connection with the issuance of, and interest on all bonds issued and outstanding pursuant to this Act, and amounts required to establish and maintain reserve and other funds and accounts established in connection therewith."

Pacific Northwest Electric Power Planning and Conservation Act of 1980, (Northwest Power Act) (Public Law 96-501):

This act, in effect, summarizes existing law and provides more detail regarding repayment policy. Section 7(a)(1), U.S.C. §839e(a)(1), provides, in part:

> "The Administrator shall establish, and periodically review and revise, rates for the sale and disposition of electric energy and capacity and for the transmission of non-Federal power. Such rates shall be established and, as appropriate, revised to recover, in accordance with sound business principles, the costs associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia Power System (including irrigation costs required to be repaid out of power revenues) over a reasonable period of years and the other costs and expenses incurred by the Administrator pursuant to this Act and other provisions of law. Such rates shall be established in accordance with sections 9 and 10 of the Federal Columbia River Transmission System Act, 16 U.S.C. 838, Section 5 of the Flood Control Act of 1944, and the provisions of this Act."

Senator EVANS. I think that there will be an appropriate time later to explain those charts so that everyone will have a chance to see some of the past and projected future payment programs.

Let's turn now to Thomas Healey, Assistant Secretary of the U.S. Department of the Treasury.

STATEMENT OF THOMAS J. HEALEY, ASSISTANT SECRETARY, DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. HEALEY. Mr. Chairman and members of this committee, I appreciate the opportunity to appear before you today to discuss the Treasury Department's views with respect to the repayment practices of BPA. In my testimony last year before the House Subcommittee on Energy Conservation and Power, I noted that Treasury, OMB, and the Department of Energy were working together to press BPA for an orderly repayment of its obligations to the U.S. Treasury. These discussions are continuing. DOE advises us that BPA has adopted a number of measures designed to improve its general record of repayments, some of which have been discussed this morning.

These steps have resulted in BPA's financial results for the current operating year being somewhat better than forecast.

The Department is pleased with the news that BPA intends to repay its current obligations and the full amount of existing interest deferrals at the end of this month, one year ahead of BPA's self-imposed schedule. Liquidation of this obligation will remove a major obstacle to the adoption of a more regularly and orderly repayment schedule by BPA.

The basis of the Treasury's position. The Treasury Department is very concerned about the slow pace of the recovery of the BPA debt to the Treasury. Between fiscal year 1979 and fiscal year 1983, BPA repaid only $2.7 million in principal out of the more than $7 billion that remains outstanding. This slow pace is made possible by BPA's repayment policy under DOE's Order No. 6120.2. This policy requires only that the principal amount of the obligations of BPA for a project be fully repaid by the final year of the useful life of the project: in general, not to exceed 50 years.

In the past 20 years, consistent with this policy, BPA has often repaid principal amounts only in the final year of a project's useful life. The problem with this approach, from the perspective of the American taxpayer, is that the bulk of the projects carry interest rates that average only 2.9 percent, well below the cost to the Treasury for its long-term borrowing, which is currently about 12.5 percent.

Consequently, by delaying repayment on these projects to the last possible moment, the magnitude of the implicit Treasury subsidy is maximized. Implementation of a fixed repayment schedule would reduce the cost of the subsidy to the taxpayer.

Treasury's current position. As you know, the Department of the Treasury is deeply concerned about the adequacy and timeliness of repayment of all agency obligations to the U.S. Treasury. From our perspective, we believe it would be very desirable for BPA to adopt a fixed repayment schedule. Bonneville's Administrator has indicated that, if a fixed repayment schedule were adopted, other meas-

ures would be necessary to facilitate its implementation. These measures would be designed to ensure BPA's financial flexibility during periods of revenue shortfalls that have been discussed this morning.

One possible measure, which apparently would require amendment of existing statutes, would authorize BPA to incorporate a contingency reserve fund into its rate base. This fund would be available to be drawn upon during periods of revenue shortfalls.

Another alternative would be for BPA to be extended a short-term borrowing line from the Treasury to finance, at current market rates, any revenue shortfalls experienced in a given fiscal year. This would only require modification in DOE's existing repayment policy, since that policy already requires BPA to pay Treasury's current market rates on scheduled interest payments that are deferred. The Treasury Department would not oppose either of these measures if it were implemented in conjunction with a fixed repayment schedule, and believes that they would provide BPA adequate flexibility to meet the legitimate requirements that stem from the nature of the BPA business.

I thank you.

[The prepared statement of Mr. Healey follows:]

FOR RELEASE UPON DELIVERY
Expected at 9:30 a.m.
September 13, 1984

STATEMENT OF THOMAS J. HEALEY
ASSISTANT SECRETARY (DOMESTIC FINANCE)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
U.S. SENATE

Mr. Chairman and Members of this distinquished Committee:

I appreciate the opportunity to appear before you today to discuss the Treasury Department's views with respect to the repayment practices of the Bonneville Power Administration (BPA). Almost one year ago, I appeared before the House Subcommittee on Energy Conservation and Power to discuss various issues pertaining to the financing of the construction of nuclear plants being built by the Washington Public Power Supply System. Among these issues was the repayment practices of BPA.

In my testimony last year before the House Subcommittee on Energy Conservation and Power, I noted that Treasury, the Office of Management and Budget (OMB), and the Department of Energy (DOE) were working together to press BPA for "an orderly repayment of its obligations . . . to the U.S. Treasury." These discussions are continuing. DOE advises us that BPA has adopted a number of measures designed to improve its general record of repayments. These include improvements in BPA's load-forecasting techniques, enhanced efforts to market surplus power, and improvements in its financial management. These steps have resulted in BPA's financial results for its current operating year being somewhat better than forecast.

The Basis of Treasury's Position

The Treasury Department is very concerned about the slow pace of the recovery of the $7 billion Federal investment in the Columbia River Power System that BPA is obligated to repay. Between FY 1979 and FY 1983, BPA made about $970 million of interest payments to Treasury, but repaid only $2.7 million of the principal of the more than $7 billion that remains outstanding. This slow pace is made possible by BPA's repayment policy under DOE's Order No. 6120.2. This policy requires only that the principal amount of the obligations of BPA for a project be fully repaid by the final year of the useful life of the project (in general, not to exceed 50 years).

In the past 20 years, consistent with this policy, BPA has often repaid principal amounts only in the final year of a project's useful life. Until the past five years--when only final-year payments of principal amounts have been made--BPA did occasionally, on an ad hoc basis, make principal payments for projects that were not in the final year of their useful lives. In any event, Bonneville has never failed to meet its obligation to repay the full amount of the principal due on a project by its final year and, in this sense, it is true that BPA has never missed a required principal payment for a project.

The problem with this approach, from the perspective of the American taxpayer, is that the bulk of the projects carry interest rates set by statute that are well below the costs to the Treasury for its long-term borrowing. Consequently, by delaying repayment on these projects to the last possible moment, the magnitude of the implicit Treasury subsidy is maximized. The acceleration in the

rate of repayment of the outstanding principal that would result from implementation of a fixed repayment schedule would reduce the cost of the subsidy to the taxpayer.

An additional concern to Treasury is BPA's substantial deferrals of interest payments since 1979. Between 1979 and 1983, a cumulative total of $218 million of scheduled interest payments to Treasury has been deferred. This occurred because DOE's repayment policy, which prescribes the order in which BPA's revenues must be expended in the event of a revenue shortfall, places payments to the Treasury at the end of the queue of creditors. Thus, in essence, Bonneville has been financing its revenue shortfalls by postponing interest payments to the Treasury.

I would note that DOE's repayment policy requires BPA to pay interest at Treasury's long-term borrowing rate on any delayed payments. As a consequence, assuming the deferred amounts are eventually repaid with interest, Treasury recovers the cost of the funds it has to borrow to finance BPA's revenue shortfalls.

The reasons for BPA's recent deferrals of interest payments to Treasury appear to lie in financial problems resulting from a series of overly optimistic forecasts of revenues, the back-to-back recessions of 1980-82, and the impact of the soaring costs of the construction of WPPSS plants 1, 2, and 3. Because revenues were lower and costs higher than expected, BPA was forced to defer interest payments to Treasury.

The frequency and extent of the interest deferrals has been one of the reasons for Treasury's serious concern about BPA's repayment practices. At the same time, however, it has been clear

that implementation by Bonneville of a fixed repayment schedule at the same time it is striving to bring its interest payments current could well impose an onerous burden on the ratepayers of the Pacific Northwest.

Therefore, the Department is especially pleased by the news that BPA intends to repay its current obligations and the full amount of the interest deferrals at the end of this month, one year ahead of BPA's self-imposed schedule. Liquidation of this obligation will remove a major obstacle to the adoption of a more regular and orderly repayment schedule by BPA.

Treasury's Current Position

As you know, the Department of the Treasury is deeply concerned about the adequacy and timeliness of repayment of agency obligations to the U.S. Treasury. From our perspective, we believe it would be very desirable for BPA to adopt a fixed repayment schedule. We believe that such an approach for determining the annual repayments to the Treasury would be highly desirable and would be consistant with the legal requirement that Bonneville use sound and prudent business practice. We have no strong views regarding the specific form of such a schedule, except to urge that standard industry practice in accounting for long-term debt be the basis for the approach adopted.

Bonneville's Administrator has indicated that, if a fixed repayment schedule were adopted, other measures would be necessary to facilitate its implementation. These measures would be designed to ensure BPA's financial flexibility during periods of revenue shortfalls.

One possible measure, which apparently would require amendment of existing statutes, would authorize BPA to incorporate a contingency reserve fund into its rate base. This fund would be available to be drawn upon during periods of revenue shortfalls.

Alternatively, BPA could be extended a short-term borrowing line from the Treasury to finance, at current market rates, any revenue shortfalls experienced in a given fiscal year that might require a deferral of principal payments to Treasury. This may only require modification in DOE's existing repayment policy, since that policy already permits Treasury to assign current market rates to scheduled interest payments that are deferred. The Treasury Department would not oppose either of these measures if it were implemented in conjunction with a fixed repayment schedule.

STATEMENT OF DANIEL C. LAMKE, SPECIAL ASSISTANT TO THE GENERAL COUNSEL, FEDERAL ENERGY REGULATORY COMMISSION

Mr. LAMKE. Thank you, Mr. Chairman and members of the committee. I would like to take this opportunity to thank the committee for this opportunity to appear and provide whatever information I can as to what the Federal Energy Regulatory Commission's responsibilities and authorities are in conforming and approving Bonneville's rates. I have provided some very short written testimony explaining where our authorities come from, the Pacific Northwest Power Electric Power Planning and Conservation Act. I am not going to go through all of our authorities at this particular time.

We feel we have very limited authorities in what we can do in requiring Bonneville to file. They do file a power payment study. As Senator Metzenbaum mentioned earlier, in 1983, we made mention that the Commission was very concerned about the repayment practices of Bonneville Power Administration inasmuch as they were deferring payments which were creating a bow wave into later years which may ultimately cause the price of the power to be so high as to be unmarketable.

We did mention that if a levelized or a more acceptable method of repayment were to occur, such as a compound amortization method, Bonneville at the close of fiscal year 1981 would have been behind in payments of some $780 million and if a straight line amortization method were to have been used, they would be behind some $1.4 billion over that same period of time. That was at the close of fiscal year 1981.

Since that time, no amortization payments have been made, so that figure would necessarily be larger. Mr. Johnson this morning

indicated also that they intend to pay some $218 million in deferrals, which is not part of the amortization. Those were operating deficiencies, so that $218 million payment would not reduce any amortization payment.

As far as repayment studies are concerned, the only thing I can update, is that at the Federal Energy Regulatory Commission meeting yesterday the Commission issued an order putting into effect on an interim basis Bonneville's transmission rate, but in that transaction we indicated BPA's development of and plan to maintain separate books of account for the Federal Columbia River Transmission System, which would include a separate repayment study for generation and transmission.

So from this point forward, we would expect two repayment studies from Bonneville Power Administration. One isolating out the cost of the transmission system and one isolating out the cost of a generation system.

Thank you.

[The prepared statement of Mr. Lamke follows:]

STATEMENT OF DANIEL C. LAMKE
OFFICE OF GENERAL COUNSEL
FEDERAL ENERGY REGULATORY COMMISSION
BEFORE THE COMMITTEE ON ENERGY
AND NATURAL RESOURCES
UNITED STATES SENATE
SEPTEMBER 13, 1984

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

BY LETTER OF AUGUST 31, 1984, THE COMMITTEE ON ENERGY AND NATURAL RESOURCES OF THE UNITED STATES SENATE INVITED FEDERAL ENERGY REGULATORY COMMISSION CHAIRMAN RAYMOND J. O'CONNOR, OR HIS DESIGNEE, TO TESTIFY.

CHAIRMAN O'CONNOR HAS DESIGNATED ME TO APPEAR BEFORE YOU AS A TECHNICAL STAFF WITNESS. I SHOULD EMPHASIZE THAT MY REMARKS REPRESENT MY OWN PROFESSIONAL JUDGMENT AND ARE NOT INTENDED TO CHARACTERIZE THE VIEWS OF INDIVIDUAL MEMBERS OF THE COMMISSION.

THE COMMITTEE'S INVITATION REQUESTED TESTIMONY WITH REGARD TO THE HISTORY AND METHODOLOGY OF BONNEVILLE POWER ADMINISTRATION'S REPAYMENT OF ITS OBLIGATIONS TO THE UNITED STATES TREASURY.

FERC'S ROLE IN REVIEWING, CONFIRMING AND APPROVING BPA RATE ADJUSTMENTS IS SET FORTH IN THE 1980 PACIFIC NORTHWEST ELECTRIC POWER PLANNING AND CONSERVATION ACT (16 U.S.C. §839(e)) PURSUANT TO WHICH THE COMMISSION IS OBLIGATED TO MAKE THREE SPECIFIC FINDINGS: THAT THE RATES:

(A) ARE SUFFICIENT TO ASSURE REPAYMENT OF THE FEDERAL INVESTMENT IN THE FEDERAL COLUMBIA RIVER POWER

SYSTEM OVER A REASONABLE NUMBER OF YEARS AFTER FIRST MEETING THE ADMINISTRATOR'S OTHER COSTS,

(B) ARE BASED UPON THE ADMINISTRATOR'S TOTAL SYSTEM COSTS, AND

(C) INSOFAR AS TRANSMISSION RATES ARE CONCERNED, EQUITABLY ALLOCATE THE COSTS OF THE FEDERAL TRANSMISSION SYSTEM BETWEEN FEDERAL AND NON-FEDERAL POWER UTILIZING SUCH SYSTEM.

THESE REQUIREMENTS ARE SET FORTH IN SECTION 7(a) OF THE 1980 ACT. SUBSECTION 7(k) OF THE ACT FURTHER SPECIFIES THAT THE COMMISSION CAN APPROVE RATES FOR THE SALE OF POWER OUTSIDE THE REGION ONLY AFTER REVIEWING THE RATES FOR CONFORMANCE WITH CERTAIN OTHER ACTS AND AFTER OPPORTUNITY FOR HEARING.

UNDER THE 1980 ACT THE FERC DOES NOT HAVE THE AUTHORITY TO MODIFY FEDERAL RATES. THE COMMISSION'S POWERS ARE LIMITED TO CONFIRMING AND APPROVING OR DISAPPROVING THE RATE. GIVEN THIS LIMITED AUTHORITY, IF BONNEVILLE'S RATES ARE INSUFFICIENT TO ASSURE REPAYMENT TO THE FEDERAL TREASURY, THE COMMISSION'S AUTHORITY IS CONFINED TO REJECTING THE RATES AND ORDERING SUBSTITUTE RATES TO BE FILED. PENDING SUBMITTAL AND APPROVAL OF SUBSTITUTE RATES, THE REJECTED, DEFICIENT RATES REMAIN IN EFFECT. IF BONNEVILLE FAILS TO FILE SUBSTITUTE RATES WITHIN THE PRESCRIBED TIME OR IF THE SUBSTITUTE RATES ALSO FAIL TO CONFORM TO THE STATUTORY STANDARDS, THE DEFICIENT RATES WILL CONTINUE TO REMAIN IN EFFECT UNTIL

THE HIGHER SUBSTITUTE RATE IS FILED BY BONNEVILLE AND CONFIRMED AND APPROVED BY THE COMMISSION.

BPA'S REPAYMENT PRACTICES WERE SPECIFICALLY ADDRESSED BY FERC IN THE COMMISSION ORDER OF JUNE 15, 1983, CONFIRMING AND APPROVING CERTAIN BPA RATES. THE COMMISSION IN THAT ORDER STATED:

> THIS BRINGS US TO A REPAYMENT PRACTICE UNDERTAKEN BY BPA WHICH WE ARE COMPELLED TO ADDRESS ALTHOUGH IT HAS NOT BEEN EXPRESSLY CRITICIZED IN PRIOR COMMISSION ORDERS. DOE'S EXISTING RULES HAVE EITHER DEMANDED OR ALLOWED BONNEVILLE TO DEVELOP A PRACTICE OF DEFERRING OR IGNORING REPAYMENT OR PRINCIPLE WHENEVER IT FAILS TO RECOVER THESE AMOUNTS OVER THE EFFECTIVE PERIOD OF ITS RATES. THUS, WHEN BONNEVILLE IS UNABLE TO COLLECT SUFFICIENT REVENUES TO MEET PAYMENTS TO THE U.S. TREASURY OVER AN EFFECTIVE PERIOD, BONNEVILLE MAKES NO ATTEMPT IN THE SUCCEEDING PERIOD TO BRING ITS REPAYMENT OF PROJECT INVESTMENTS BACK TO REASONABLE SCHEDULE. INSTEAD, BONNEVILLE PREPARES A NEW REPAYMENT STUDY WHICH ASSUMES THAT THE INVESTMENT ON THE BOOKS AT THE TIME WILL BE PAID OVER THE REMAINING TERM LEFT IN THE REPAYMENT PERIOD. THIS PRACTICE HAS THE EFFECT OF CONTINUALLY PUSHING BONNEVILLE'S REPAYMENT OBLIGATION TO FUTURE RATEPAYERS. THE ULTIMATE RESULT OF THIS PRACTICE IS TO GENERATE A "BOW WAVE" OF UNPAID INVESTMENT COSTS WHICH ARE CONTINUOUSLY DEFERRED WITH AN EVER INCREASING LEVEL OF ANNUAL PAYMENTS REQUIRED WITH EACH SUCCEEDING RATE FILING.
>
> WHILE THE METHODS AND ASSUMPTIONS USED BY BONNEVILLE MAY BE ARGUABLY CONSISTENT

> WITH DOE PROCEDURES, THE CONTINUATION OF SUCH POLICIES AND PRACTICES WILL INEVITABLY RESULT IN THE NEED TO RECOVER SUBSTANTIAL SUMS REPRESENTING DEFERRED FEDERAL INVESTMENT DURING THE LIMITED PERIOD OF TIME REMAINING AT THE CONCLUSION OF WHAT WOULD BE CONSIDERED A REASONABLE AMORTIZATION PERIOD. THIS PRACTICE WOULD LOGICALLY RESULT IN THE NEED TO OVERPRICE POWER AND ENERGY IN THE FUTURE TO MAKE UP MAJOR DEFICIENCIES, WHICH PRACTICE COULD READILY MAKE SUCH POWER ECONOMICALLY UNMARKETABLE.

THE COMMISSION IN ITS JUNE 15, 1983, ORDER REVIEWING BONNEVILLE'S RATES MEASURED BPA'S REPAYMENT PRACTICES AGAINST TWO OTHER TYPES OF REPAYMENT ALTERNATIVES. FIRST, ASSUMING A TYPICAL 50-YEAR REPAYMENT PERIOD FOR FEDERAL INVESTMENTS IN THE SYSTEM AND USE OF A COMPOUND AMORTIZATION METHOD, THE COMMISSION CONCLUDED THAT BONNEVILLE IS BEHIND IN ITS PAYMENTS TO THE U.S. TREASURY BY MORE THAN $780 MILLION AS OF THE END OF FISCAL YEAR 1981. SECOND, USING A STRAIGHT LINE DEPRECIATION METHOD, BPA'S REPAYMENTS ARE BEHIND BY $1.4 BILLION OVER THE SAME PERIOD.

THIS CONCLUDES MY PREPARED STATEMENT. I WOULD BE PLEASED TO RESPOND TO ANY QUESTIONS YOU MAY HAVE.

Senator METZENBAUM. In your oral testimony, I think in your written testimony, you indicated in 1981 Bonneville was $780 million behind, that the Commission concluded they were $780 million behind at the end of fiscal year 1981. Can you tell us how much they are behind as of today?

Mr. LAMKE. I have not calculated anything, but just in an estimation, perhaps Bonneville has better figures, I notice in their 1983 cost of service analysis their planned amortization for 1984 and 1985 are some $117 million and $107 million. I have to assume that 1982 and 1983 would be somewhere along those same type figures of $100 million a year.

Senator METZENBAUM. So it is about $300 million more?

Mr. LAMKE. That I think would be an estimate and Bonneville I think could perhaps provide better figures.

Senator EVANS. I wonder if we could perhaps go to the last speaker. There is one last person to testify.

Senator METZENBAUM. He had talked about this $1.4 billion they are behind in straight line depreciation basis, which is in your written testimony.

Mr. LAMKE. Excuse me, I missed your question, Senator.

Senator METZENBAUM. I was not trying to get into any questions.

Senator EVANS. Mr. Lamke, you might read the last paragraph of your written testimony.

Mr. LAMKE. The Commission in its June 15, 1983 order reviewing Bonneville's rates measured BPA's repayment practices against two other types of repayment alternatives. First, assuming a typical 50-year repayment period for Federal investments in the system and use of a compound amortization method, the Commission concluded that Bonneville is behind in its payments to the U.S. Treasury by more than $780 million as of the end of fiscal year 1981. Using a straight line depreciation method, BPA's repayments are behind by $1.4 billion over the same period.

Senator METZENBAUM. Thank you.

Senator EVANS. Last is Kevin Boland, Senior Associate Director, Resources, Community and Economic Development Division of the General Accounting Office.

STATEMENT OF F. KEVIN BOLAND, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JOHN BROWN, GROUP DIRECTOR FOR ELECTRICITY, GENERAL ACCOUNTING OFFICE

Mr. BOLAND. Thank you, Mr. Chairman and members of the committee. First, let me introduce John Brown, who is at my left. John is the group director who has followed the BPA issue for several years and has been directly responsible for the work GAO has done in this area.

This morning my comments will be based largely on the work that we have done and reports issued and testimony offered over the last several years. I have a relatively brief statement, and I think it provides the perspective and context for my summary of where GAO's position is on this issue.

Again, we appreciate the opportunity to discuss this subject. The Federal investment, as has been said, stands at $7.9 billion. The Federal law requires Bonneville to repay this investment. The Bonneville Project Act of 1937 requires that power rates be set to include the recovery of the cost of producing and transmitting the electricity as well as the amortization of the capital investment over a reasonable period of years.

Subsequent legislation, including the 1974 Federal Columbia River Transmission System Act and the 1980 Pacific Northwest Electric Power Planning and Conservation Act, require Bonneville to repay the Federal investment and set electric power rates at the lowest possible level consistent with sound business practices.

However, the Transmission Act also provides that Bonneville apply revenues to pay for the costs of operation and maintenance, purchased and exchange power, and transmission service before paying the amortization of the Federal investment. The Federal investment is the lowest category for payment, therefore, if revenues are insufficient to cover all expenses the Federal investment is deferred.

Except for a requirement of the 1974 Transmission Act, that transmission lines be repaid within 35 years and the authorizing legislation for the third powerhouse at Grand Coulee Dam that it be repaid in 66 years, Bonneville's other legislation is silent with regard to what constitutes a reasonable period of years for repayment.

The Department of Energy has adopted a repayment period for each project of 50 years. This means that Bonneville expects to pay off each project within 50 years after it is placed in service.

Bonneville began repaying the Federal investment in 1939 using a cost-based method for determining revenue needs which incorporated a fixed annual repayment schedule. Using this schedule, it repaid about $364 million through fiscal year 1965. At that time it represented about 20 percent of the investment made. At that time, Bonneville switched to a repayment study method for determining revenue requirements when it became apparent that power rates would have to be increased to cover the scheduled repayments.

Under the repayment study method, according to Bonneville, annual repayments are not required to be made; Bonneville need only repay the Federal investment by the end of the project's repayment life rather than satisfy fixed annual repayments. I think some statistics are useful at this point.

Between fiscal years 1966 and 1972, Bonneville repaid about $231 million toward the Federal investment using the repayment study method. During the past 11 years, however, 1973 to 1983, Bonneville has repaid only about $43 million toward the investment in the Columbia River Power System. Bonneville experienced operating losses in 9 of the last 11 fiscal years, which impacted on its ability to repay the Federal investment.

Since revenues were insufficient to cover expenses, Bonneville deferred the repayment of the Federal investment into the future. At the close of fiscal year 1983, Bonneville had paid the U.S. Treasury a total of $638.3 million or about 8 percent of the total Federal investment.

Now, for the repayment status. In March 1983, Bonneville's Administrator made a commitment to reduce costs and increase rates in order to prevent nonrepayments on the Federal investment from occurring in the future. Bonneville provided in its fiscal year 1983 rate filing for recovery of deferred interest.

In recognition of the economic condition of the region, the Administrator determined that this burden would be built into the rates over a 3-year period. Bonneville developed revenue estimates to repay $595 million through fiscal year 1985, including $217 million of interest and deferred interest and $378 million scheduled for amortization to repay the portion of the Federal investment. Payments were to be made in each of the fiscal years 1983 to 1985.

However, Bonneville experienced an operating loss in fiscal year 1983 and no payments were made. Bonneville's rates for the period November 1, 1983 to July 1, 1985 were designed to recover the $217 million—I might say at this point, Bonneville uses $218 million and a rounding off of the figure would also get you to that point—interest and deferred interest plus $247 million scheduled for amortization in fiscal years 1984 and 1985 for a total repayment of $464 million.

For fiscal year 1984, the first year of that rate filing, Bonneville estimated that it would pay $153.4 million in deferred interest. Bonneville has indicated that it may be able to pay more than this amount by the end of fiscal year 1984, and the Administrator provided those figures this morning.

Since 1981, GAO has been concerned about Bonneville's repayment situation. In both a June 1981 report and an October 1983 report, we recommended that in order to assure timely and equitable repayment of the Federal investment, Bonneville should replace its repayment study method of determining revenue requirements with a cost-based method incorporating a fixed annual repayment schedule, similar to what they had prior to 1965.

In the October 1983 report, we noted Bonneville's efforts to catch up on repayments by fiscal year 1985, but also noted that while Bonneville raised its power rates to increase revenues by 58 percent in fiscal year 1983, it still expected a revenue shortfall. This shortfall ultimately occurred and no payments were made.

We believe that a cost-based method would provide the discipline needed for revenue and repayment sufficiency. Further, we recommended that a cost-based method should provide a provision that late or missed repayments incur interest costs at a higher project interest cost or the Treasury's cost of borrowing at the time.

Bonneville has not adopted our recommendations. It and the Department of Energy's basic concern with our recommendation is that a cost-based method incorporating a fixed annual repayment schedule would reduce the Administrator's flexibility to deal with changing conditions and that revenue shortfalls could still occur. We recognize these concerns, but we believe options are available to address them. I use one example and that is from the Tennessee Valley Authority, which is required to repay $1 billion of Federal investment and it is on a fixed annual repayment system and is allowed to defer repayments for up to 2 years when unusual circumstances occur. Such an option or others could accommodate Bonneville's concern with regard to needed flexibility.

To sum up, we recognize that Bonneville's Administrator has made recent efforts to catch up on repayments by fiscal year 1985. While the Administrator's current commitments are commendable, we believe a cost-based method with a fixed annual repayment schedule would place more discipline in the repayment process and help assure its consistent application over the long run. We believe that is very important.

It is simply important when one considers that 92 percent of the Federal investment in the Columbia River Power System remains to be paid in future years.

That concludes my statement and we would be pleased to respond to any questions the members of this committee may have.

[The prepared statement of Mr. Boland follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C.

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M.
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STATEMENT OF F. KEVIN BOLAND
SENIOR ASSOCIATE DIRECTOR
RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to discuss the Bonneville Power Administration's (Bonneville's) repayment to the Treasury of the federal investment in the Columbia River Power System as well as prior GAO work in this area.

The federal investment in the Columbia River Power System stands at about $7.9 billion. Federal law requires Bonneville to repay this investment. The Bonneville Project Act of 1937 (16 U.S.C. 832f) requires that power rates be set to include the recovery of the cost of producing and transmitting the electricity as well as the "amortization of the capital investment over a reasonable period of years." Subsequent legislation, including the 1974 Federal Columbia River Transmission System Act (16 U.S.C. 838g) and the 1980 Pacific Northwest Electric Power Planning and Conservation Act (16 U.S.C. 839e), require Bonneville to repay the federal investment and set electric power rates at the lowest possible level consistent with sound business practices. However, the Transmission Act also provides that Bonneville apply revenues to pay for the costs of (1) operation and maintenance, (2) purchased and exchange power, and (3) transmission service before paying the amortization of the federal investment. The federal investment is the lowest category for payment, therefore,

if revenues are insufficient to cover all expenses the federal investment is deferred.

Except for a requirement of the 1974 Transmission Act that transmission lines be repaid within 35 years and the authorizing legislation for the third powerhouse at Grand Coulee Dam that it be repaid in 66 years, Bonneville's other legislation is silent with regard to what constitutes a "reasonable period of years" for repayment. The Department of Energy has adopted a repayment period for each project of 50 years. This means that Bonneville expects to pay off each project within 50 years after it is placed in service.

Bonneville began repaying the federal investment in 1939 using a cost-based method to determining revenue needs which incorporated a fixed annual repayment schedule. Using the fixed repayment schedule, it repaid about $364 million through fiscal year 1965. At that time, Bonneville switched to a repayment study method for determining revenue requirements when it became apparent that power rates would have to be increased to cover the scheduled repayments. Under the repayment study method, according to Bonneville, annual repayments are not required to be made; Bonneville need only repay the federal investment by the end of the project's repayment life rather than satisfy fixed annual repayments.

Between fiscal years 1966 and 1972, Bonneville repaid about $231 million toward the federal investment using the repayment study method. During the past 11 years (fiscal years 1973 to 1983), however, Bonneville has repaid only about $43 million toward the federal investment in the Columbia River Power System. Bonneville experienced operating losses in 9 of the last 11 fiscal

years which impacted on its ability to repay the federal investment. Since revenues were insufficient to cover expenses, Bonneville deferred the repayment of the federal investment into the future. At the close of fiscal year 1983, Bonneville had paid the U.S. Treasury a total of $638.3 million or about 8 percent of the total federal investment.

REPAYMENT STATUS

In March 1982, Bonneville's Administrator made a commitment to reduce costs and increase rates in order to prevent nonrepayments on the federal investment from occurring in the future. Bonneville provided in its fiscal year 1983 rate filing for recovery of deferred interest. In recognition of the economic condition of the region, the Administrator determined that this burden would be built into the rates over a 3-year period. Bonneville developed revenue estimates to repay $595 million through fiscal year 1985 including $217 million of interest and deferred interest and $378 million scheduled for amortization to repay the the portion of the federal investment in the Federal Columbia River Power System that Bonneville's repayment study showed would be payable 1983 through 1985. Payments were to be made in each of the fiscal years 1983 to 1985.

However, Bonneville experienced an operating loss in fiscal year 1983 and no payments were made. Bonneville's rates for the period November 1, 1983, to July 1, 1985, were designed to recover the $217 million interest and deferred interest plus $247 million scheduled for amortization in fiscal years 1984 to 1985 for a total repayment of $464 million.

For fiscal year 1984, the first year of that rate filing, Bonneville estimated that it would pay $153.4 million in deferred

interest. Bonneville has indicated that it may be able to pay more than this amount by the end of fiscal year 1984.

GAO REPORTS ON REPAYMENT

Since 1981 we have been concerned about Bonneville's repayment situation. In both a June 1981[1] report and an October 1983 report,[2] we recommended that in order to assure timely and equitable repayment of the federal investment, Bonneville should replace its repayment study method of determining revenue requirements with a cost-based method incorporating a fixed annual repayment schedule. In the October 1983 report, we noted Bonneville's efforts to catch-up on repayments by fiscal year 1985, but also noted that while Bonneville raised its power rates to increase revenues by 58 percent in fiscal year 1983 it still expected a revenue shortfall. This shortfall ultimately occured and no payments were made. We believe that a cost-based method would provide the discipline needed for revenue and repayment sufficiency. Further, we recommended that a cost-based method should provide a provision that late or missed repayments incur interest costs at a higher project interest cost or the Treasury's cost of borrowing at the time.

Bonneville has not adopted our recommendations. Bonneville and the Department of Energy's basic concern with our recommendation is that a cost-based method incorporating a fixed annual repayment schedule would reduce the Administrator's flexibility to

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[1]Policies Governing the Bonneville Power Administration's Payment of Federal Investments Need Revision, EMD-81-94, June 16, 1981.

[2]Policies Governing the Bonneville Power Administration's Payment of Federal Investments Still Need Revision, EMD-84-25, Oct. 26, 1983.

deal with changing conditions and that revenue shortfalls could still occur. While we recognize their concern, we believe options are available to address them. For example, the Tennessee Valley Authority (TVA), which is required to repay $1 billion of federal investment, is on a fixed annual repayment system and is allowed to defer repayment for up to 2 years when unusual circumstances occur. Such an option or others could accomodate Bonneville's concerns with regard to needed flexibility.

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To sum up, we recognize that Bonneville's Administrator has made recent efforts to catch-up on repayments by fiscal year 1985. While the Administrator's current commitments are commendable, we believe a cost-based method with a fixed annual repayment schedule would place more discipline in the repayment process and help assure its consistent application over the long run. This is important when one considers that 92 percent of the federal investment in the Columbia River Power System remains to be paid in future years.

This concludes my prepared statement. I would be pleased to respond to any questions you may have.

Senator EVANS. Thank you very much. If it is agreeable to the members of the committee, could we confine our questions in rounds of 10 minutes, so that way we can get through all of the members' questions. I notice that Chairman McClure has joined us. Do you have any comments at this moment, Mr. Chairman?

Senator MCCLURE. No. The only comment was to thank you for chairing. I appreciate it very much.

Senator EVANS. If we can start, questions will be aimed at any one and all members of the panel. We thank you all for your testimony. The first question is addressed to everyone. Does anyone here believe that Bonneville in any way has violated the law in terms of its repayment program?

Mr. Lamke?

Mr. LAMKE. Certainly not.

Senator EVANS. Mr. Healey?

Mr. HEALEY. No, sir.

Senator EVANS. Mr. Boland?

Mr. BOLAND. No, sir, there is no violation.

Senator EVANS. I presume Mr. Johnson does not feel so.

Mr. JOHNSON. You heard the report.

Senator EVANS. Mr. Johnson, certainly on these questions some of them will probably be more closely aimed at the details Mr. Ailshie brought to us, but is it legal for Bonneville to change repayment schedules particularly on the hydroelectric facilities from 50 years to a longer period? I understand that the Third Powerplant of Grand Coulee has a specified time of repayment of 66 years. Is 50 years your choice of what constitutes a reasonable time for repayment?

Mr. JOHNSON. I believe this was set, Mr. Chairman, by the Department of the Interior a number of years back. It has not been changed by the Department of Energy as Bonneville became part of that new department. I do not feel that I have the authority to change those life years of Federal investments.

Senator EVANS. Would it require a change in the statute in your view or a change in policy by the Department of the Interior?

Mr. JOHNSON. That was in the committee report and it would have to be, I think, dealt with in a similar fashion.

Senator EVANS. Mr. Ailshie, you reported that, in your testimony, that rates could not be raised from 1974 to 1979. Is that an accurate assumption or is it just that rates were not raised from 1974 to 1979?

Mr. AILSHIE. No, sir, the contracts that were in place at that time and had been in place all of the previous history of Bonneville provided that we could raise rates every 5 years. Those contracts were revised as we approached the end of the 1979 period to allow annual rate increases when necessary.

Senator EVANS. There have been many figures thrown around this morning, mainly in payments of principal. Could you give us some impression of the total payments made by Bonneville to the Federal Treasury, including interest?

Mr. AILSHIE. We have one of the charts, Senator——

Senator EVANS. I think it might be useful to get that chart at this time.

Mr. AILSHIE. It is a chart titled "Funds Returned to the U.S. Treasury," and it reflects payments to the Federal Treasury since it was organized. We have handouts of this chart also, if you are having trouble seeing it. Through 1974, BPA had a cumulative total of $2,227 million returned to the Federal Treasury and cumulative through 1983, we have returned $4,219 million to the U.S. Treasury; $672 million of that is for corps and Bureau O&M at the Federal projects that are operated on a multipurpose basis, where there is some cost allocation to navigation, flood control, and other benefits.

BPA O&M prior to 1974, when we went off of appropriations was $460 million and interest for the corps and Bureau appropriations $1.4 billion, BPA interest $943 million, and BPA interest on our outstanding bonds of $315 million. Our amortization payment, as we mentioned earlier, has been $638 million.

Senator EVANS. You may want to comment on some of the comments, of Bonneville's being behind in payments by various amounts. Is it accurate that Bonneville currently has paid at or prior to the designated time period all principal payments that have been called for?

Mr. AILSHIE. Yes, sir. We interpret the fixed date for the repayment of each investment to be no longer than 50 years for generation and the reasonable service life for the 35 to 45 years for transmission and in that sense, we have not missed any of those absolute commitment payments.

Senator EVANS. It is an interesting differential between reasonable service live for all other facilities and 50 years for generation facilities, especially for hydroelectric facilities. Is 50 years a reasonable expected life?

Mr. AILSHIE. It is not the average service life that the corps and the Bureau have determined in applying their depreciation schedules. Those range up in the seventies to 89-year range with a composite of somewhere around 83, I believe.

Senator EVANS. Mr. Healey, you talked about orderly repayment of its obligations and then you talked about delaying repayment on these projects until the last possible moment. The magnitude of the implicit Treasury subsidy is maximized. What do you mean by implicit Treasury subsidy?

Mr. HEALEY. To give you a simple example, take a million-dollar project. If BPA pays an average rate of 2.9 percent, by waiting to pay until next year instead of paying that million dollars this year, BPA pays 2.9 percent, which would be $29,000. But the Treasury's borrowing cost at 12.5 percent on that same million dollars would be $125,000. So Treasury would pay $125,000 and would receive $29,000. The $96,000 difference is the implicit subsidy.

Senator EVANS. I understand. Are you suggesting that this practice is inappropriate?

Mr. HEALEY. Yes, sir.

Senator EVANS. Let's assume you were a homeowner with a mortgage, of 4.5 to 5 percent. But the bank, in order to finance the borrowings to you and others, may be borrowing money currently at 10 or 12 percent. Do you suggest they should renegotiate the mortgage that you hold?

Mr. HEALEY. I think your example is a very good one. The point, though, is that orderly repayment on my mortgage is required. I have to pay principal every year. I happen to have a 30-year mortgage. I have to pay principal every year for 30 years. I cannot wait until the 30th year to pay off the full value of the mortgage.

Senator EVANS. There are many different kinds of mortgage instruments today. Many of them call precisely for that—a balloon payment at the end of a fixed period of time. The important question is: if you make a deal, do you believe that the deal should be changed in midstream, unilaterally?

Mr. HEALEY. I clearly do not. I think that the nature of the deal with respect to Bonneville's repayment of its investments is set by DOE policy. It is not set by any contractual obligation prescribing a schedule for repayment of principal.

Senator EVANS. In other words, if you have a handshake, you can renege on the handshake. But if you have a fixed contract in writing that you cannot escape, then you do not escape from that. You seem to be saying that because it is only policy instead of law, we can unilaterally go ahead and change it if we desire.

Mr. HEALEY. I think I was trying to suggest the reverse. The policy allows BPA to adjust its payment schedule every year so as to maximize the time of deferral.

Senator EVANS. Is it not correct that this has been the case—and right from the beginning—the opportunity to adjust to policy?

Mr. HEALEY. I don't believe so. I believe that the repayment policy was changed.

Senator EVANS. But the opportunity under the law for that policy has been there all along.

Mr. HEALEY. I cannot give you a legal answer to that question. But I believe the policy was changed sometime in the past to the repayment-study method and prior to that a different method had been used.

Senator EVANS. My 10 minutes are up. Sentor Metzenbaum.

Senator METZENBAUM. Mr. Healey, on that mortgage that you have at your home, if you are late in your payment for 60 days, does the entire amount become due and payable? Mine does. Everybody else I know does. When I was a banker, every mortgage I ever saw did and I never heard of any arrangement where you could just throw it over at 2.9 percent under those circumstances, have you, Mr. Healey?

Mr. HEALEY. I think that is the case. Fortunately or unfortunately, I have never had my payment late by as much as 60 days.

Senator EVANS. I would call that fortunate, not unfortunate.

Senator METZENBAUM. Mr. Boland, has the GAO computed the difference between the Government market rates and the rates that have been charged BPA on its entire obligation?

Mr. BOLAND. Let me answer it this way and maybe this will answer your question, Senator. I think BPA on an overall average is paying interest of 4.5 percent. That is based on what the interest rate was at the time the projects were, I guess, placed into operation. So any repayments made with that interest rate in today's marketplace is going to be lower than what the Treasury has to pay to borrow that same money.

Senator METZENBAUM. Mr. Johnson, you are talking about repaying some money in 1985. Will you repay that in connection with the oldest amount of the debt or with respect to the debt that bears the higher rate of interest in connection with new monies that the government has made available to you?

Mr. JOHNSON. First, that would be a payment on principal, those that might be due because of the conclusion of their life years and after that we would pay off the low interest first.

Senator METZENBAUM. The low interest first?

Mr. JOHNSON. Right—excuse me, the high interest first. The record stands corrected.

Senator METZENBAUM. Would it not be a correct business practice and be fair to the Federal Government to pay on the debt that you owed the longest, which would be the low interest, wouldn't it?

Mr. JOHNSON. I think the best business decision for the Administrator in connecting his responsibilities in the Pacific Northwest would be to pay off the high interest first.

Senator METZENBAUM. So, therefore, the Federal Government would be subsidizing you that much more?

Mr. JOHNSON. I think that would be implicit in the deals when they were struck and the original indebtedness was taken down.

Senator METZENBAUM. Has anyone computed the difference between what the Government pays for this money, over the years, and the interest rate that has been charged to BPA? Has the GAO computed that?

Mr. BOLAND. We have not, Senator.

Senator METZENBAUM. You have not?

Mr. BOLAND. Have not.

Senator METZENBAUM. As I look over there on that chart, do I understand that each year the Federal Government is providing additional investment in the BPA?

Mr. JOHNSON. The degree to which we draw down from the Treasury under our authorities, the Federal Government is serving as the source of finance for those capital expenditures.

Senator METZENBAUM. How much will you get from the Federal Government this year?

Mr. AILSHIE. September 30, 1984 we intend to negotiate a bond with the Treasury for $200 million.

Senator METZENBAUM. The Treasury is going to—they are going to borrow another $200 million from the Treasury?

Mr. AILSHIE. Yes, sir. That bond is set in accordance with the terms of a memorandum of understanding with the Treasury and the Treasury earns or makes about one, somewhere between a half to three-quarters of a percentage point on the interest rate. It is set at a rate higher than the current Treasury interest rate by about a half to three-quarters of a percent.

Senator METZENBAUM. Mr. Healey, in the new bonds that they take on, and I notice that they keep going up there from 7.6 to 8.2, 8.7 and 9.2, 9.6 percent, on these new loans, will the Treasury get some commitment that the first amortization funds to be paid will be in connection with the old money or the new money, because it is just a question of who out negotiates whom on that. And if you are giving them additional money, why does not the Federal Gov-

ernment insist that the amortization payments be made in connection with the cheap money that is owed by BPA?

Mr. HEALEY. I think you have asked a couple of different questions. Let me see if two points will answer them. One, all recent borrowings by BPA, including the borrowings this year, are made at market rates and under market terms that Treasury believes are fair to the U.S. Government as well as to Bonneville.

On the second question, the current borrowings are of funds that have been authorized by Congress under terms that have been set out in several different acts that have authorized the amounts. They do not refer to amortization of prior Bonneville borrowings.

Senator METZENBAUM. Mr. Johnson, why is it that—why is BPA opposed to recommendation of all of the other Government agencies involved in this matter? The Treasury Department strongly supports GAO's recommendation that BPA adopt a fixed repayment schedule. FERC also appears to be supportive. Why does BPA oppose a fixed repayment schedule?

Mr. JOHNSON. My responsibility is to carry out the law as it is presently written and the policy as promulgated by the Department of Energy and that is exactly what I have been doing. I have not per se been opposing any ideas that have been suggested by parties.

I think my responsibility on the other hand is to carry out and make the current methodology work and I believe I have demonstrated that can be done.

Senator METZENBAUM. Could you live with the fixed repayment schedule if you were ordered to do so either by Congress or by other agencies of the Government?

Mr. JOHNSON. I could live with the law. I think my responsibility would be to carry out the will as expressed in the law passed by the Congress. There would have to be provisions for the flexibility that the agency needs. Because recognize that it is in the current repayment methodology that the agency gets its working capital. That is my short-term line of credit that I get from the bank.

When I run into my difficulties, either with a bad water year or a cost overrun, a bad economy, I have to have some means to deal with that. The current flexibility in the repayment methodology provides for that. So if there were at some future date to be a fixed payment of some kind, there would also have to be provisions to cover those contingencies.

Senator METZENBAUM. Some contingencies, but I think Mr. Healey addressed himself to two possible ways that that can be done, either with a reserved fund, and I think you had another one as well in your testimony. Am I correct, Mr. Healey?

Mr. HEALEY. Yes, sir. The other suggestion was that there would be a short-term borrowing line set up at the Treasury to allow BPA to have more operating flexibility in terms of its short-term funds.

Senator METZENBAUM. Mr. Boland, at the present time BPA does not owe $7.9 billion; it owes about $8.3 billion. Is that correct, Mr. Boland? Do you agree with that?

Mr. BOLAND. I will take their figures, Senator. Our figures were as of 1983, but additional investments make that go up and down.

Senator EVANS. I think the figure on the left is the total investment, but there has been some amortization. The third one from the right is the unamortized investment.

Senator METZENBAUM. What does the term schedule mean, whoever made the chart? Did you, Mr. Ailshie?

Mr. AILSHIE. Yes. That amount on that chart shows our total Federal investment that is in place at the end of 1983 and we are planning to have through 1987, the planned or actual amoritization that we plan to make during those years and the cumulative amortization that we will have made if plans go like we have them scheduled now of $1.3 billion by the end of 1987. The unamortized investment is the amount left to pay off.

Senator METZENBAUM. But even if you made those payments, the obligation of BPA to the Federal Government would continue to increase and would not decrease. Is that not correct?

Mr. AILSHIE. Generally correct, yes, sir.

Senator METZENBAUM. So unless we get a repayment schedule, as Mr. Boland has pointed out, there would be serious danger to the security of the Federal Government's investment in Bonneville and particularly is that true in view of the fact that the obligation seems to be increasing each year even if you meet your own anticipated amortization payment, which is a big if?

Mr. AILSHIE. Perhaps I could take a moment, if you like, sir, and look at one other chart that we have that is a graph entitled "Interest and Amortization Payments for Generation Projects," and I think we might get a perspective on how our payments are actually planned and scheduled.

We, as Mr. Lamke suggested in his testimony, we are now preparing two separate schedules of repayment, one for the generation projects and one for the transmission projects. The generation projects are by and large the lower interest investments that are of concern to most of the parties that have commented on the repayment practices of Bonneville. This graph demonstrates or depicts the actual cost that Bonneville is incurring for generation and how we are going to build those into rates over future periods.

Senator METZENBAUM. In view of that chart and some of the things you are saying, it is a fact then, isn't it, that if there were a fixed repayment schedule agreed upon, so that the entire Federal obligation were to be paid off in the 50-year period, you could live with it, provided that you had some contigency allowances in the event of some special problems, such as short rainfall?

Mr. AILSHIE. I think that there is obviously—you can live with just about anything that is put upon you. In order to function in a viable way, we went back and reviewed what TVA did in the fifties when they were in this kind of situation. We reviewed our situation and what it would take in order to be sure that we end up with a good business like approach. Recognizing that the Federal Government is the owner of these facilities; is the benefactor of the ownership, whether that benefaction be good or bad; that we would need to look at a system of management organization and authorities for rate setting. Right now our process requires us to go through 18 months of procedures to change our rates, at which time they are reviewed by FERC. TVA can change their rates in 30 days.

I think it is more than just a contingency fund we would want to look at a overall system that would allow us the flexibility to manage the Bonnevile Power Administration.

Senator METZENBAUM. Mr. Ailshie and Mr. Johnson, we have at least 3 months before the Congress can take this matter up again. During that period, would you provide the chairman of the committee and certainly a copy to myself or to me and a copy to the committee, either way, your proposal as to some fixed understanding between the government and BPA vis-a-vis the matter of repayment of the debt according to a fixed repayment schedule. That proposal should spell out exactly what you think that repayment plan ought to be and spell out what you think is the right approach from the standpoint of a contingency arrangement. You should also address yourself, if you want to, Mr. Ailshie, the need to provide some procedures in connection with your rights to set power rates. Can that be done, Mr. Johnson?

Mr. JOHNSON. Let me put it this way. It is certainly not within my authority to change the methodology. I accept what you say in this context, and I will certainly consult with the Secretary as to an appropriate response. I think it is a matter of the Department and the Secretary of Energy and certainly with members of this committee.

Senator METZENBAUM. I don't think I got an answer. I am asking you—I am not asking you to consult with anybody—I am asking you to provide me with your proposal as to how, if there should be a fixed repayment schedule, what contigencies if any, are needed, and what other changes in the law, if any, are needed.

Now, you do not need to consult with anybody to do that. What I am saying to you is that if you do not come up with that kind of proposal, then I am certain that at some point we are going to be able to put together a majority in Congress and provide it ourselves. And truthfully, I don't think this would be good for BPA and I don't think it is good for the Government.

So I am really asking you to accept the responsibility. The Government has a right to be repaid and I am asking you to figure out how we are going to get repaid, when and what changes, if any, to provide for contingencies and what changes if any you need in the law. And I am asking you to advise me of that within the next 90 days.

Mr. JOHNSON. The point that I am concerned about, Senator is simply, you are asking me to recommend a method and I do not think that is my prerogative.

Senator METZENBAUM. I am not asking you to recommend. I am asking you to tell me how it can be done.

Mr. JOHNSON. We will cooperate with this committee and with the other persons represented at this table today and I will consult with the Secretary of Energy. I think it is his prerogative. I will let him know the request that you have made on the Department through me today and certainly we will cooperate in every way we can.

Senator METZENBAUM. Mr. Chairman, I do not think my request is an unreasonable one. What I am concerned about is that you and I and Senator Evans and such others that want to be involved will find ourselves on the floor with some language mandating a

particular procedure and I am not sure that is good for BPA. I am trying to get BPA to accept its own responsibility, and I wonder if I could prevail upon you to join me in this request.

Senator EVANS. Perhaps Mr. Johnson's problem is that such a request is a policy matter for the Secretary of Energy, not for the BPA Administrator. In providing the technical means of how a different methodology would work, Bonneville may strongly recommend that it not be done, judging that it is a bad idea. I think that such a dilemma is probably part of Mr. Johnson's difficulty.

Mr. Chairman.

The CHAIRMAN. Let me make this comment, because I think I understand where Mr. Johnson is coming from. I know where you are coming from, Senator Metzenbaum. You are asking that Bonneville Power Administration exercise a discretion which they do not have under the statute, to make recommendations with respect to things that are outside the purview of their discretion. And I understand Mr. Johnson's response in that context.

I think, however, the point that Mr. Metzenbaum makes is valid, that Congress may in the absence of recommendations take actions that are not as advisable as they might otherwise be. I think the recommendation really would have to come from the Department of Energy rather than from BPA.

I want to make the point, and I am sorry Senator Metzenbaum had to leave, but I will make it to him again, but the Bonneville proposal on rates is on the chart, that is their projection, that is what they intend to do on repayment. If you want to look at what their recommendation to the Congress is, they have made it.

I think what has not come out yet is why it is made that way. It is made in an effort to level the rates so that you do not get a bow wave of high rates in the short term. If you will look at the chart that is before us right now, that is exactly what is shown, varying repayment schedules, some varying components of interest and debt in order that the rate structure over that period of time can be relatively level.

I guess from the singular point of view of trying to get money back to the Treasury as soon as possible, to minimize the impact upon Federal borrowing, they could care less what the consumers of the Northwest have to pay in the short run in terms of rates. The consumers of the Bonneville system have to be very much concerned about what the rate effect is on various repayment schedules.

In that connection, and again I am sorry Senator Metzenbaum is not here right now because I will have to repeat it to him privately, and I will, Bonneville is going through a period of adjustment like many others are across the country, in which energy costs escalate rapidly. Bonneville was caught in that period with a couple of other events. One was a 5-year contract that could not be adjusted rapidly enough to adjust to the change in costs. Bonneville is also going through a period of time when the hydrobase system was inadequate to all of the needs when they got involved through the hydrothermal accords and then later with the Washington Public Power Supply System and the impact on rates as they went to a higher proportion of thermal load.

The WPPS problems have exacerbated that problem. I can't help but make parenthetical note that in some of Congressman Weaver's statements, he indicated that Bonneville had acted irresponsibly with respect to the bonding requirements with respect to the WPPS project. I think Bonneville acted extremely responsibly during that period of time and I want to commend Mr. Johnson and the entire Bonneville agency for the way in which they tried to accommodate to the very extreme difficulties that were imposed by the failure of the WPPS project and to meet the Bonneville responsibilities under contracts with WPPS on plants 1, 2, and 3 and to separate responsibly again, I think their own liability with respect to 4 and 5.

Some of those issues are still before the courts and will be ultimately resolved in the courts. I do not know what more Bonneville could have done during that period of time to minimize the financial impact upon the ratepayers of the Northwest, the financial impact of BPA itself and the financial impact of the U.S. Treasury to ban the actions that they have taken.

I think some other actions that Congressman Weaver has suggested would have brought about utter chaos and would have maximized the rate and cost impact rather than minimized it. Now, that is a difference of opinion and he is entitled to his opinion and I am entitled to mine. The question of rate structure in the near term is to correct for some deficiencies of the past and I think this is a point that must be made most strongly, that nobody is trying to say everything was done perfectly in the past. Nobody is trying to indicate that adjustments did not have to be made. But I think it is fair to say that the adjustments are being made, that there is a plan for repayment. That plan for repayment is before this Congress and Congress has to act now to determine whether that repayment plan is correct or not.

I happen to believe that under the circumstances to ask them to come up with a fixed repayment schedule, in view of the varying liability schedules that they have, but a fixed repayment schedule for only a portion of their obligations would maximize rate impact upon consumers.

Now, Mr. Boland, isn't that correct?

Mr. BOLAND. I appreciate your views, Mr. McClure. But since we walked out on this issue more than once, perhaps a couple of minutes of our reasoning might be useful. We used the guidance the Congress gave us and BPA has to follow the administrative setting. Keep the rates as low as possible, consistent with sound business practices and principles.

We also have some other criteria to follow from legislation. Amortize that investment over a reasonable period of time. So it is a tough balance to strike when you are using that criteria. When we look at the fixed payment schedule and, again, we have some history to go on as to what Bonneville used up to 1964, when it dropped that method, we see a discipline that helped Bonneville meet its requirements.

Now, what we see in the restructuring, the repayment study method is an opportunity, if you will, for Bonneville to roll into the future amortization requirements. Now, that has a dual effect. That does not only result in maybe an unsanctioned burden on the

general taxpayer, but it also creates some concern for the region in the future when his payments come due. Obviously, you can only roll that amortization so far into the future before you have to pay up.

Now, our concern is we might wish away that event, but it is going to face us eventually and I think that is a concern, so it is not a fixed payment solution. It is keeping in mind the general taxpayer as well as region in keeping in the lines the Congress gave us.

The CHAIRMAN. I understand that. Mr. Boland, have you seen their repayment plan?

Mr. BOLAND. I have not seen the specifics, Senator. I will say the discipline and the statements that the Administrator has made, beginning in 1962 when he made his commitment, are somewhat in line with the fixed repayment schedule. We are saying we are committed to making interest payments by such and such a time. We are committed to making amortization payments until such and such a time.

The clear facts, and this is where it comes out to what a commitment means and how that might be applied when they use a different method, is that the amortization expected to be paid for 1983, when that commitment was made in 1982, has been rolled into future years in this most recent commitment.

So between 1982 and today's commitment come 1985, the Treasury will actually realize somewhere between $130 million and $140 million less than if that amortization as scheduled has been met.

The CHAIRMAN. But over the period of the repayment the Treasury will get the same amount of money, will they not?

Mr. BOLAND. When you get to the end of time, yes, sir.

The CHAIRMAN. And do you see anything in the repayment schedule as presented here that indicates that Treasury will not be paid?

Mr. BOLAND. No, I don't see that sir, but the problem is that it is at a fixed point in time and the problem we have stated with the repayment method is that you never know when you are ahead or when you are behind.

The CHAIRMAN. It depends upon how you calculate it and obviously you can calculate it in either of two or three different ways. Is it not also true that if interest is deferred, not principal, interest is deferred that that interest is at current, that the charge for repayment of that interest that is deferred is at current market rates? There is no additional cost to Treasury.

Mr. BOLAND. Since 1972 Bonneville has followed the policy of paying the highest debt obligations first.

The CHAIRMAN. That was not my question. My question is if as a matter of fact they fail to make an interest payment on date, that is due date, if the interest payment itself is deferred, the repayment of that interest at a later date will be together with interest at current market rates.

Mr. BOLAND. I am not sure. Maybe Treasury would be the best to respond.

The CHAIRMAN. Mr. Healey.

Mr. HEALEY. Yes, that is correct, Senator McClure.

The CHAIRMAN. So that the Treasury cannot suffer in total aggregate repayments to them because of deferral. Bonneville might, because Bonneville would be paying more interest because of the deferred principal payment and therefore they will pay more interest over life.

But is it not good business practice to minimize immediate near term effects, if you can, if you are under a congressional mandate to minimize rates?

Mr. BOLAND. I think where you sit is where you stand and I think from the standpoint of the administrator, it may be very good sound business practice.

The CHAIRMAN. I notice that Senator Metzenbaum made some comment about his own personal finances and about whether or not he would pay his own mortgage. Maybe that justifies me in making some comments about my own. Many years ago, I borrowed on my GI life insurance. That is a 4-percent loan. I have not paid one nickel of that principal back. I would be foolish to pay that off first and the administrator would be derelict in his duties if he did not minimize the cost to the consumers in his area and instead maximize it.

I suspect Senator Metzenbaum did not become a millionaire by that kind of business practice. It is easy to criticize people, but you ought to sit in their seat once. You ought to look at their problems and all I am trying to say is Bonneville has an accumulated set of problems. We have also passed the Northwest Power Act and in that power act, we require investments in conservation. Senator Metzenbaum asked about current borrowing. Part of the borrowings are conservation.

We require mitigation for fish and game. Some of the current borrowings and some of the current expenditures are fish and game expenditures for mitigation. The ratepayer is being hit all at once with a whole host of new requirements during a period of time when there has been very, very rapid rate escalation throughout the Northwest for a variety of reasons. That happens to impact in Senator Evans' and Senator Gorton's State much more than it does mine because that is where the bulk of the marketing takes place.

But I know something of the ratepayer and consumer advocacy group responses to the rate changes that have taken place already and I do not suspect that the ratepayers of the Northwest are going to feel much better that the rate is doubled because of Federal action rather than some other action, when there is the alternative of leveling those rates over a longer period of time without cost to the Treasury. Treasury will get all of their money back with the scheduled interest.

I do not think that the Bonneville Administrator is derelict in his duty at all in seeking that kind of a solution, nor would I suggest that Treasury or others looking at that question can say, hey, wait a minute; we would rather favor the taxpayers of the United States by getting that money back, no matter what it does to the consumers of the Northwest.

Mr. BOLAND. As I say, Senator, we would not be of that view. Again, as I hoped I communicated we are not favoring the general

taxpayer in taking the position as we do at the expense of the ratepayers in the Northwest.

The CHAIRMAN. And I would suggest too, when we look at these questions, and this is not an unmixed question, we look at the investments in the Federal dams in the Pacific Northwest and we may well look at the Federal investments in rivers and harbors in Ohio and we will get some repayment schedule on those with imputed interest as well, past, present and future.

I don't say that as a threat and I only say it to make a point. But the Federal Government has made investments in public works for the benefit of the American public and those benefits are not always spread evenly across the United States. Rivers and harbors affect the Columbia River basin, because there is some investments of the Columbia River basin. But we don't benefit a great deal from the investments made on the Mississippi system.

But, nevertheless, the Federal Government elected to make those investments and we do not require repayment of those investments. I get a little bit testy when we look at certain kinds of Federal public works investments and say they have got to pay back and they have got to pay back with interest, when at the same time we have other public works investments that do not pay us back a dime, not one thin dime, let alone interest.

Senator EVANS. Let me just add, Mr. Chairman, one very specific example, which the taxpayers of the Northwest are helping to share without undue complaint, perhaps because they do not know about it. That is the St. Lawrence Seaway Development Corporation. When the St. Lawrence Seaway was built, it benefited a good share of the country but not the Northwest. But it soon fell behind on its payback to the Federal Treasury. First, 1970, the Congress canceled interest payments. In 1978 and 1981 the debt payment was restructured, decreasing the amount scheduled for redemption and on December 18, 1982, Congress canceled the outstanding revenue bond of a $110 million.

I wonder if at that time either Treasury or GAO or anyone appeared and suggested that that was the wrong thing to do.

Mr. HEALEY. I cannot speak for that time, because that was not my watch. The proposal we have seen on my watch relates to the REA Program, and we have testified often and loudly against the forgiveness of the REA debt.

Senator EVANS. Mr. Boland, was that on your watch?

Mr. BOLAND. It was not on my watch, I am glad to say. I will say, of course, GAO is out to provide assistance and guidance to the Congress. If the Congress puts into law requirements for repayment over a certain period of time, it is our responsibility to give you the best of our professional opinion on how that can be applied.

The CHAIRMAN. Mr. Boland, I appreciate that, but could I follow through with just this much? I think we have to be awfully careful when we look at different methodologies and then say, by this methodology they are behind. As a matter of fact, the current methodology for good or for evil is current methodology and if we are going to judge BPA's performance, are they meeting the statutory requirement or not, then we ought to look at current require-

ments rather than comparing it to some other requirement that might have been put in place.

Mr. BOLAND. I think in terms—I have to break it down in amortization and interest. Under the repayment study method, Senator McClure, we could never say they are behind, because they are never behind. It is factored in, again, it is rolled into the future.

The CHAIRMAN. But, Mr. Boland, would it not be better than, say, compared to a straight line amortization they are behind—

Mr. BOLAND. Oh, yes.

The CHAIRMAN. We could say that there is no way for us to know whether they are behind; we think they ought to be on a repayment schedule.

Mr. BOLAND. Yes, and FERC has made that estimate.

The CHAIRMAN. I don't object to having some kind of a repayment schedule. I do suggest, however, to say that we are on a fixed amortization schedule with contingency allowals is no fixed repayment schedule at all. It is just semantics.

Mr. BOLAND. We have suggested some other provisions, and again I think it is fair to say, you just can't arbitrarily say a fixed repayment without understanding what that could entail in some of the provisions. We said there could be other provisions built into that fixed repayment which would require repayment after a certain period of time or if it was not provided then, then the interest costs would at least be equal to what the Treasury has to pay for that money.

The CHAIRMAN. Those are prospective changes?

Mr. BOLAND. Yes.

The CHAIRMAN. And I think in response to the question that was asked by Senator Evans, his first question, was there any violation, is there any violation of the current law and your answer was, no, there is not.

Mr. BOLAND. That is right.

The CHAIRMAN. Taking from that what we are talking about is a prospective change not a dereliction of the past.

Mr. BOLAND. That is right.

Senator EVANS. Mr. Healey and Mr. Boland, under a proposed fixed repayment schedule, presumably that would require additional payments to the Treasury over those now being made by Bonneville, especially in the near term. That presumably in turn would require an increase in rates. If rates are increased to the point that some of the major industries of the Northwest shut down, the aluminum industry being one, which is at full operation is, what, 20 percent of the load or close to it?

Mr. JOHNSON. Thirty.

Senator EVANS. Almost 30 percent of the total load and they can go from 100 percent to zero very quickly, because the multinational aluminum companies have other places to produce aluminum. If the markets are bad, they can shut down the first year. Have you accomplished anything if in the process of raising rates to meet a fixed schedule you minimize revenues? Aren't what we are really talking about is the opportunity to deal with rates in a sensitive and flexible way to maximize revenues and not maximize rates?

Mr. BOLAND. Maybe I can respond, Mr. Chairman. I guess I would not without analysis and taking into consideration the plans

that Bonneville already has in a commitment stage made with the proposed rate increases and their commitment to meet amortization deferral, I guess I would not just assume that changing methods would be increasing rates.

In other words, if I assume that Bonneville is on the right track now, the proposed rates are going to generate the revenues. Their sales forecast is going to be consistent with those revenue needs. Their costs are going to be in line with how they estimate it and their repayments are going to be met, then I would say nothing has changed for rates. But it does set an expectation which if it is not met has to be justified and it is not justified just by rolling it into the future.

If it has to be justified, a flexible repayment schedule does flag it for those who have to ask tough questions and it does flag it for the administrator who has to make tough decisions, again, consistent with sound business practices. And if he does not think it makes good sense to raise rates, he can say so. There could be, again, other provisions to accommodate a repayment to the Treasury.

All we are saying is that it provides a discipline to take some action. There is a whole range of actions that that could lead to, not necessarily rate increases.

Mr. HEALEY. If I can answer on behalf of Treasury, I don't think we have any presumption as to, that repayment would necessarily occur earlier or that there would be an increase in rates. No one, to my knowledge, has suggested that the amortization ought to be straight line. Treasury has not seen, and maybe no one has done adequate work to determine, what the method of amortization should be. Indeed Mr. Johnson has suggested that amortization might be over a life that would be longer than that currently used. This could, in some years, have the possibility of even lowering rates.

Senator EVANS. Let me see if I can summarize all of this. From what I have heard this morning Bonneville has never violated the law. They have always paid on time or before hand the principal payments. You are both saying that you are not even presuming that a fixed repayment program would require any increase or change in rates. If there is a delay in interest payments, that deferral is charged an interest penalty so that there is no cost to the Treasury or to the taxpayers of the United States. If all that is true, I have got ask: What is the problem?

Mr. BOLAND. I guess, Mr. Chairman——

Senator EVANS. Unless you are doing what you said you were not going to do—that was try to benefit taxpayers in other parts of the country at the expense of the Pacific Northwest ratepayers.

Mr. BOLAND. No; I guess I look at it, is it a problem when only 8 percent of the investment has been repaid?

Senator EVANS. Now, wait just a minute. When was the bulk of the current investment acquired?

Mr. BOLAND. That is a fair comment. Some of that investment is newer than other investment.

Senator EVANS. Let's get a little more precise than that. How much of it has been incurred in recent years compared with earlier years?

Mr. AILSHIE. Senator, there is a chart we have which might help us visualize that a little better, entitled "Cumulative Investment 1910 to 1985," and on this chart you can see the growth in BPA investment over the years. I might add that the majority of the investment occurring after 1975 has been the investment that is financed out of bonds.

Senator EVANS. Before we go any farther, would you take that chart down so we can look at the one that was up there before? I think that is an important point to make. Of this whole amount of money that is listed, is it accurate to say that the gray and the orange—the combination of net billed amortization and net billed interest—is on a fixed repayment program? In other words, there are bonds with fixed periods of amortization and they must be paid on that time.

Mr. AILSHIE. Yes, sir.

Senator EVANS. So the whole question of a flexible repayment programs is only on the Federal investment, which is a relatively small share of what you are talking about and a small share of the total. This means that the huge bow wave that some talk about is even less likely because they are looking at the total picture without recognizing that the major share of total debt is already on a fixed repayment program.

I think I interrupted you. Let's go back and put the cumulative investment chart up there. Let's go back to the house mortgage. If you had a 13 percent 30-year mortgage, after 5 years, how much of the principal do you think would have been paid off?

Senator METZENBAUM. It depends on what your principal payments are, what your mortgage payments are.

Senator EVANS. No; I am talking about even a straight line, even an average annual payment or a straight line mortgage. I can tell you it is darn little, that in any straight line fixed or in almost any other kind of repayment program, the principal payments accelerate toward the end. So it makes good economic sense that not much of the principal of the total investment has actually been repaid when you consider that most of it has been acquired in very recent years.

Mr. BOLAND. That is fair, Mr. Chairman. I had our 1983 report, which I think maybe gets more at the heart of the repayments and I guess if we look at repayments over a 11-year period for 1972 to 1983, we find that in three of those years there were no repayments made. In 1980 there was a repayment made of $75,000. In another year there was a repayment made of $940,000. In the others it is all between $3 and $7 million except for 1975, there it was $21 million.

I think it is, again, all we are trying to do is say is there a better way to repay that investment consistent with the guidance and the principles that the Congress set out and that BPA is following.

Senator METZENBAUM. Aren't you just saying it ought to be put on a businesslike basis?

Mr. BOLAND. Yes; and I think there is probably a lot of room for judgment as to what is businesslike and what is the sense of equity in this as it applies to BPA rates and the general taxpayer.

The CHAIRMAN. Mr. Chairman, could I follow through on that for just a moment, because you keep looking at historical precedent at

the evolution of the problem and perhaps I am looking at the fact that we are now on a better course of action that does not yield the same kind of problems. But you have suggested a fixed rate, fixed amortization schedule, but with certain contingencies.

Is it not likely that if they had been on a fixed repayment schedule they still would not have made the payments in those years? They would have exercised the contingencies.

Mr. BOLAND. I don't know. Hindsight is—

Senator METZENBAUM. Would they not adjust their rates in order to take care of that? They have made some projections and promises.

The CHAIRMAN. Perhaps you did not hear Mr. Ailshie's response to your question and why between 1974 and 1979 they had a problem. They had fixed contracts. They could not adjust rates with fixed contracts without abrogating the contracts. A bad water year occurs, there is a shortage of revenue. They would have exercised a contingency. Short water years did occur. Maybe we need to, if we are really to flesh out the picture, go back and look at why those payments were not made and I do not support the fact that the payments were not made. They already changed from a 5-year contract to an annual rate adjustment, although the latest rate proposal is on a 27-month basis because of the difficulty in going through a rate case on an annual basis.

But are we not really more criticizing the past than we are looking at the present and I will join with you in the criticism of the past.

Mr. BOLAND. I think what it gets down to is would a different process give more confidence over the long term, and that is not tied to the personal commitment of any one administrator and what the experience has been in recent times.

The CHAIRMAN. And I agree with that.

Senator EVANS. Mr. Metzenbaum.

Senator METZENBAUM. Mr. Lamke, what has been Bonneville's track record when it comes to making those payments that it has projected in the past?

Mr. LAMKE. Mr. Boland has testified that that track record is not very good. But to put it in perspective from the Commission's standpoint, there is nothing inherently wrong with the power repayment study; it is the performance of that. If the actuality of the payments occurred under the power repayment study as they are set forth, we would not have a problem.

The problem with the Commission is that under the statute it says that we are supposed to make sure that the rates are sufficient to assure repayment of the Federal investment. There comes a point in time that if deferrals are put off and put off and put off, down to the tailend, we can no longer assure that the Federal investment is going to be paid in a reasonable amount of time.

Senator METZENBAUM. Mr. Johnson, I had to leave and I understand that Senator McClure responded and I understand he was not in agreement with me with respect to my request of you. Notwithstanding that, I want to reiterate the request. I want you to tell us whether you favor them or do not favor them, what kind of schedule repayment—to make available to us a schedule of repay-

ment and also what kind of contingency provisions you would need and what else, if anything, is needed even if you disagree with it.

But I am asking you to make that available to me within the next 90 days. I will go beyond this committee and I think it is a subject that, if you decide not to respond, that it is a matter to which I would address myself on the floor of the Senate the next time this issue comes up.

I am seeking technical assistance. I am not seeking your policy views on the subject.

The CHAIRMAN. Excuse me, would you repeat what you said last?

Senator METZENBAUM. I am seeking his technical advice. I am not asking him to address himself to the policy consideration and the final determinative question of whether or not there should or should not be such a schedule put into effect and formalized, but what it would have to be or what it could be or should be if Congress or some other body decides that it should be put into effect.

And I am asking also for such provisions as they may need in order to provide for contingencies.

Mr. JOHNSON. The trouble I have, Senator Metzenbaum, is with words like proposal and advice. It is not my prerogative. I think this is the prerogative of the Secretary of the Department of Energy, but certainly he will be aware of the request that you have made and he can respond. But I stand ready to cooperate with any of the parties represented at this table, certainly this committee in engaging in studies, anything that would cast more light on this thing and perhaps lead to legislation that the Congress would believe would be better than what presently exists.

I want to emphasize that it is my responsibility now to make the existing law work and I feel that I have met that test. I feel that we have put in place within the agency fiscal controls, commitment to cost control, long-range planning techniques that will not disappear with the passage of administrators.

To the contrary, I think the whole matter is viewed in an altogether different light and I think that we can look at the future with greater confidence that the current methodology will in fact be effective.

Senator METZENBAUM. All right.

Senator EVANS. We are having something of a problem here, since the Senate leadership is asking us to return to the floor for a vote. Are there further questions, recognizing that all members will have the opportunity to submit written questions to all of the witnesses. Maybe we will have to address Mr. Lamke with written questions. He has been sitting rather quietly there outside of the shot and shell. I will have a couple of questions, and I am sure others will as well.

Thank you all for coming. I think this has been a very helpful presentation. As Senator Metzenbaum pointed out in his opening statement, this certainly does not represent the end, but merely the beginning of trying to understand and respond better the difficult questions in Bonneville's repayment program.

Thank you, gentlemen.

[Whereupon, at 11:50 a.m., the hearing was adjourned.]

[The Public Power Council submitted the following statement for the record:]

PUBLIC POWER COUNCIL

August 29, 1984

The Honorable Dan Evans
United States Senate
818 SHOB
Washington, D.C. 20510

RE: BPA Repayment Schedule

Dear Senator Evans:

The Public Power Council is quite concerned about recent efforts by members of the Congress from outside the Pacific Northwest to change the method by which the Bonneville Power Administration determines its obligations to recover the federal investment in hydroelectric facilities. The system Bonneville uses was established with the full knowledge and consent of the Congress over the past 40 years and has consistently been supported by Congressional action. All five of the power administrations use the system.

We believe that the Bonneville Power Administration has already taken the steps needed to overcome the problems which have led to these proposals for change. We acknowledge that Bonneville has not only failed to make amortization papyments for the past several years, but in several recent years has been unable to pay all of its interest obligations annually.

We believe that the pending large payment of deferred interest which Bonneville will make later this month and the schedule which Bonneville has adopted to catch up on deferred amortization payments demonstrate that Bonneville can meet its obligations within the existing repayment system and that therefore there is no reason to make a major change.

Bonneville, with the cooperation of its customers, has changed its procedures to address the major problems which it encountered over the last few years. These changes are entirely consistent with the letter and spirit of RA 6120.2, the Department of Energy order which governs the repayment system.

Public Power Council 500 W. Eighth Street, Suite 110 Vancouver, WA 98660-3007 (206) 694-8593

Bonneville's short-run problems with repayment over the past few years stem from the three main causes. First, Bonneville lacked the ability to forecast and track its costs in the face of the need to assume repayment of the debts on WPPSS plants #1, #2, and #3. Second, Bonneville was unable to forecast revenues accurately due to inaccurate load forecasts. Third, Bonneville had long-standing contract terms with its customers which prevented it from adjusting rates frequently enough. Let me discuss each of these in turn.

First, the overruns associated with construction of the WPPSS nuclear plants caused Bonneville's costs to exceed forecasts and helped reduce payments to the Treasury. With the support of the Public Power Council, Bonneville introduced in the last rate case a Supply System Adjustment Clause, which allows Bonneville's rates to change in response to unexpected changes in WPPSS costs. Ironically enough, the adjustment clause was not needed this year, due to the reduced pace of construction of the Supply System plants, and due to the fact that the Supply System is better forecasting its budgetary needs. Bonneville also introduced, with PPC support, an adjustment clause designed to protect the agency from changes in the cost of power purchased from exchanging utilities. Bonneville's cost forecasting has markedly improved, and Bonneville's ability to adjust its rates to respond to changes in important cost categories has also improved.

Second, Bonneville's revenue forecasts have not been very accurate because Bonneville's load forecasts have not been very accurate. This is due largely to the fact that electrical rates have been going up proportionally faster in the Pacific Northwest than in any other part of the country. Like electric load forecasters elsewhere in the United States, planners here did not fully appreciate the extent to which rising electric rates reduce electric load, but the large percentage increase in price here had a larger effect on load than elsewhere.

Load forecasting in the Northwest has become far more conservative. The most recent Bonneville load forecast has loads rising at just 1.6% a year. The Public Power Council has worked with Bonneville to improve their forecasting tools. For example, BPA's forecasts of nongenerating utility customer and Direct Service Industrial customer loads were especially unreliable prior to the last rate proceeding. In that proceeding, BPA adopted PPC's suggestions for a new forecasting model for nongenerating utility loads far superior to BPA's previous model and developed an independent DSI load forecasting model instead of merely relying on DSI operating demands. These changes represent a major improvement in BPA's forecasting capability.

As electrical rates have risen, the loads of many aluminum smelters in the Northwest have begun to vary with the business cycle. This helped contribute to BPA's repayment problems in 1980-1981. With the support of the Public Power Council, BPA has introduced a DSI customer charge to provide an incentive for aluminum companies to keep their plants operating, and has provided an incentive rate to the aluminum companies if aluminum prices fall, helping Bonneville to preserve as much revenue from the aluminum companies as possible, even in recessions.

Third, beyond problems in forecasting techniques, BPA's problems in repaying its debt were largely due to BPA's prior legal inability to raise rates between 1974 and 1979 and between 1979 and 1981. Bonneville can now raise its rates annually if needed, which allows it to more quickly reflect changes in loads and costs.

The Public Power Council does believe that BPA's current repayment technique is cumbersome and difficult to understand. In concert with other Northwest parties, the PPC has proposed an alternative to Bonneville's repayment method. This proposal was to use the linear programming (LP) approach to determine the revenue requirements needed to repay the Federal investment. The linear programming method is a clear, widely accepted method that can be used consistently with RA6120.2 to determine the appropriate revenue requirement needed to pay off Bonneville's obligations, with less ambiguity than the current approach, and in a manner amenable to outside audit. If changes in BPA's repayment methodology are being considered, the PPC urges that serious consideration be given to a linear programming method.

Bonneville still needs flexibility in its repayment methodology. The amount of hydro Bonneville will have to sell will still vary from year to year, and business fluctuations will still affect loads. However, we have learned from experience, and we have put new mechanisms into place to drastically improve Bonneville's repayment performance.

The proof of this is that apparently Bonneville is going to meet all or substantially all of its obligations to the Treasury this year, despite problems with the disposal of the regional power surplus and some softening in aluminum loads near the end of the year. Bonneville has acquired the tools to prevent a recurrence of its earlier problems, and major changes in the repayment system are therefore not required at this time.

Sincerely,

Daniel M. Ogden, Jr.
Manager

APPENDIX

Additional Questions Submitted for the Record

QUESTION FROM SENATOR METZENBAUM TO MR. HEALEY

1. In your testimony you referred to the effect of an "implicit interest rate subsidy." Please provide a complete explanation of this subsidy in the context of the BPA repayment issue. How much does this subsidy cost the Treasury?

Answer. Prior to 1965, BPA used a fixed repayment schedule, which meant that principal payments for a project were scheduled to be made each year. In 1965, in order to achieve greater financial flexibility for Bonneville, the Department of the Interior approved a change in the fixed repayment approach to what is now known as the repayment study method.

The repayment study method requires Bonneville to demonstrate that its power rates are adequate to provide for repayment of the Federal investment within a period of 50 years. Bonneville is no longer required to adhere to a fixed repayment schedule. Instead, it is only obligated to repay the principal on a project by the end of its useful life (generally, 50 years for generation projects and 35 years for transmission projects).

The GAO report, "Policies Governing Bonneville Power Administration's Repayment of Federal Investment Still Need Revision," notes that the only substantive change in the repayment practice of Bonneville after 1965 occurred in 1972 ". . . when Bonneville began to apply a policy of making repayments on its highest interest-bearing debt first. . . ." The repayment study method and the practice of paying highest interest-bearing debt first are now firmly established under DOE's repayment policy (DOE Order 6120.2).

Currently, more than $6.0 billion of the outstanding Federal investment is comprised of Federal appropriations for projects that carry interest rates that involve an implicit Federal subsidy. That is, the interest rates on projects funded through Federal appropriations carry interest rates that are less than Treasury's cost of borrowing for comparable maturities at the time each project went into service. In fact, the weighted average interest rate on outstanding generation projects is about 2.9 percent; the weighted average rate on investments in transmission projects is slightly higher at 3.9 percent. Treasury's borrowing costs during the period when those projects were funded averaged 4-6 percent. BPA's borrowings from the Treasury under the Transmission Act of 1974 and the Regional Power Act of 1980 are at current market rates (averaging about 14 percent), and no subsidy is involved.

While the purpose of the change to the current repayment method was to provide financial flexibility to BPA, it also has had the effect of enabling Bonneville to maximize the interest rate subsidy. That is, the combination of changing from a fixed to a flexible repayment schedule and of repaying the highest interest-bearing debt first results in BPA keeping low interest rate debt for as long as possible. In fact, there is no incentive for Bonneville to make

principal payments on these projects before their scheduled maturities.

The Treasury recognizes that the Congress clearly intended that Federal appropriations to construct generation and transmission facilities be assigned below-market interest rates. However, it believes that the increase in the subsidy caused by the delayed principal payments goes beyond Congress' intent. The cost of this subsidy can be substantial, as the following example suggests.

Example

Assume that Bonneville is obligated to repay $100 million of principal for a generation project that has a useful life of two years. Because of an interest-rate subsidy, the project carries an interest rate assumed to be 3.0 percent, well below the assumed rate on Treasury securities of 12.0 percent. Finally, assume that any principal payments made by Bonneville occur at the end of a fiscal year, consistent with BPA's current practice.

Table 1 presents estimates of Bonneville's principal and interest payments to the Treasury as well as estimates of the interest subsidy to Bonneville under two repayment approaches. One approach, "the level payment option," corresponds to the approach used by Bonneville until 1965, when it converted to the repayment study method. The alternative approach, "balloon payment option," corresponds to the approach now effectively being used by Bonneville.

Under the level payment option, Bonneville pays a total of $4.52 million of interest to the Treasury over the two years. The interest subsidy equals the difference between the interest that would have been paid had the projects carried Treasury's borrowing cost of 12.0 percent and the interest actually paid by Bonneville. In this case, the subsidy equals $13.82 million.

Under the balloon payment option, in which Bonneville pays principal only at the end of the second year, the interest paid by BPA is $6.00 million, well below the interest cost of $24.00 million that would have been paid at the Treasury rate. In this case, the interest subsidy to Bonneville equals $18.00 million, which is 30 percent larger than the subsidy implied by the level payment option.

Conclusion

Treasury believes that the interest rate subsidy implied by the repayment study method goes well beyond what the Congress intended. While the current approach used by BPA for determining its repayments provides needed financial flexibility to the agency, it imposes an additional cost on the general taxpayer in the form of a larger subsidy. While analysis to ascertain the actual magnitude of the subsidy has not been undertaken, we believe that it is significant. Therefore, on the assumption that steps are taken to ensure Bonneville's financial flexibility, Treasury favors a return to the fixed repayment approach.

COMPARISON OF THE INTEREST RATE SUBSIDY UNDER
ALTERNATIVE REPAYMENT METHODS, A HYPOTHETICAL CASE
(dollars amounts in millions)

	Year 1			Year 2			Total		
	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Level Payment Option									
Payments with interest subsidy	$49.26	$ 3.00	$52.26	$ 50.74	$ 1.52	$ 52.26	$100.00	$ 4.52	$104.52
Payments without interest subsidy	47.17	12.00	59.17	52.83	6.34	59.17	100.00	18.34	118.34
Interest subsidy to BPA		9.00			4.82			13.82	
Balloon Payment Option									
Payments with interest subsidy	--	3.00	3.00	100.00	3.00	103.00	100.00	6.00	106.00
Payments without interest subsidy	--	12.00	12.00	100.00	12.00	112.00	100.00	24.00	124.00
Interest subsidy to BPA		9.00			9.00			18.00	

	Interest Subsidy to Bonneville Under the:		Increase In Subsidy	
	Level Payment Option	Balloon Payment Option	Amount	Percentage
Exhibit: Increase in subsidy to BPA from the adoption of the balloon payment option	$ 13.82	$18.00	$4.18	30.2%

Office of State and Local Finance
U.S. Department of the Treasury
October 9, 1984

[The Bonneville Power Administration did not respond to the following questions submitted by Senator McClure and Senator Metzenbaum.]

ADDITIONAL QUESTIONS FOR BPA FROM SENATOR MCCLURE

1. Please identify the steps BPA has taken to give greater confidence that repayment will be made.
2. Outline the major features and purpose of the "self-financing" legislation that was passed in 1974 Federal Columbia River Transmission System Act (FCRTSA).
3. How are utility capital payments generally structured? Please discuss with respect to investor-owned utilities, publicly-owned utilities, and the Tennessee Valley Authority (TVA); and compare to the structure of capital payments of BPA. Are capital payments i.e., debt investment normally repaid on a straight-line or mortgage type basis?
4. Please provide a comparison of BPA's interest rates under the Federal Columbia River Transmission System Act (FCRTSA) with those of Tennessee Valley Authority (TVA) and compare these with current Treasury interest rates.

ADDITIONAL QUESTIONS FROM SENATOR METZENBAUM TO MR. JOHNSON

1. I want to reiterate my request for your technical assistance in formulating a fixed repayment schedule method that includes the necessary flexibility. I am not asking for a BPA-backed proposal; you have made your objections to a fixed repayment schedule very clear. Instead, I would like you to submit a complete formulation of a fixed repayment schedule that would work if implemented.

In arriving at this formulation, please consult with the Treasury Department, GAO, and FERC. If changes in existing law would be needed, please explain. Please make your submission within 90 days.

2. Please describe the extent to which BPA's backing of the net-billed WPPSS plants has contributed to BPA's difficulties in repaying the Federal investment in the FCRPS.
3. What are BPA's plans with regard to finishing WPPSS 1 and 3? How much will it cost to finish these plants?
4. What will be the effect of finishing WPPSS 1 and 3 on BPA's ability to repay the Federal investment in the FCRPS? Please provide analysis of a best-case scenario, a most-likely case scenario, and a worst-case scenario.
5. Please explain how BPA intends to handle the coming "bow wave" in mortization payments. Specifically:

(a) How will the bow wave affect BPA's ability to repay the Federal investment?

(b) Will BPA need to raise rates in order to meet the bow wave repayment? If so, when would rates be raised and how much would they be raised?

6. Please explain the status of efforts to sell Northwest power to California. Specifically:

(a) How much power is currently being sold to California? At what price, and under what terms and conditions?

(b) How much power is currently being negotiated for? At what price, and under what terms and conditions?

(c) What is the relationship between the outcome of the current negotiations and BPA's ability to repay the Federal investment? Please provide analysis of a best-case scenario, a most-likely case scenario, and a worst-case scenario.